CASES DECIDED
in
THE UNITED STATES
COURT OF CLAIMS

FEBRUARY 1, 1977 TO APRIL 30, 1977

WITH

REPORT OF
DECISIONS OF THE SUPREME COURT
IN COURT OF CLAIMS CASES

REPORTED BY
AUDREY BERNHARDT
REPORTER

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JUDGES AND OFFICERS OF THE COURT

Chief Judge
WILSON COWEN[1]

Judges

OSCAR H. DAVIS
BYRON SKELTON
PHILIP NICHOLS, JR.
SHIRO KASHIWA
ROBERT L. KUNZIG
MARION T. BENNETT

Senior Judges

JAMES R. DURFEE
DON N. LARAMORE

Chief, Trial Division
ROALD A. HOGENSON

Trial Judges

C. MURRAY BERNHARDT
MASTIN G. WHITE[2]
LLOYD FLETCHER
GEORGE WILLI
LOUIS SPECTOR
DAVID SCHWARTZ
HARRY E. WOOD
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LOU ELLA L. INGRAM

Bailiff-Marshal
CHARLES A. LINK, JR.

[1] Chief Judge Wilson Cowen retired and was recalled on March 1, 1977, and is now serving as a Senior Judge with the court.
[2] Retired, effective January 1, 1971, and recalled as a senior trial judge.
[3] Retired effective March 9, 1977.
[4] Entered on duty March 14, 1977.

ASSISTANT ATTORNEYS GENERAL

(Charged with the defense of the Government)

February 1 to April 30, 1977

PETER R. TAFT
Land and Natural Resources Division

MYRON C. BAUM
Acting Assistant Attorney General
Tax Division

IRVING JAFFE
Acting Assistant Attorney General
(February 1 to February 16, 1977)

BARBARA A. BABCOCK
Acting Assistant Attorney General
(February 17 to March 10, 1977)

Assistant Attorney General
(March 11 to April 30, 1977)
Civil Division

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No. 11616 dated Aug. 26, 1971; Bendure
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No. 11901 dated Jan. 30, 1976; Bendure

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DESIGNATION OF A JUDGE OF THE UNITED STATES COURT OF CLAIMS FOR SERVICE IN ANOTHER CIRCUIT

The Chief Justice of the United States, the Honorable Warren E. Burger, pursuant to the authority vested in him by Title 28, United States Code, designated and assigned the Honorable Oscar H. Davis, a Judge of the United States Court of Claims, to act as a Circuit Judge of the United States Court of Appeals for the Second Circuit during the period March 14 to March 18, 1977, and for such further time as may be required to complete unfinished business.

DESIGNATIONS OF JUDGES OF THE UNITED STATES COURT OF CLAIMS FOR SERVICE ON THE UNITED STATES COURT OF CUSTOMS AND PATENT APPEALS

The Chief Justice of the United States, the Honorable Warren E. Burger, pursuant to the authority vested in him by Title 28, United States Code, on April 15, 1977 individually designated and assigned the following judges of the United States Court of Claims to perform judicial duties of a judge of the United States Court of Customs and Patent Appeals for the period April 1, 1977 to March 31, 1978 and for such additional time in advance thereof to prepare for the trial of cases, or thereafter as may be required to complete unfinished business:

Oscar H. Davis, Acting Chief Judge
Philip Nichols, Jr.
Shiro Kashiwa
Robert L. Kunzig
Marion T. Bennett

DESIGNATIONS OF JUDGES OF THE UNITED STATES COURT OF CUSTOMS AND PATENT APPEALS FOR SERVICE ON THE UNITED STATES COURT OF CLAIMS

The Chief Justice of the United States, the Honorable Warren E. Burger, pursuant to the authority vested in him by Title 28, United States Code, on April 15, 1977 individually designated and assigned the following judges of the United States Court of Customs and Patent Appeals to perform judicial duties of a judge of the United States Court of Claims for the period April 1, 1977 to March 31, 1978 and for such additional time in advance thereof to prepare for the trial of cases, or thereafter as may be required to complete unfinished business:

Howard T. Markey, Chief Judge
Giles S. Rich
Phillip B. Baldwin
Donald E. Lane
Jack R. Miller

TRIBUTE TO CHIEF JUDGE WILSON COWEN

March 7, 1977

Upon the convening of court this date, Judge Davis, as the Acting Chief Judge, called attention to the retirement of Chief Judge Cowen effective March 1, 1977, and paid tribute to him for his service to the court and the bar. He stated as follows:

"At this first court session after Chief Judge Wilson Cowen has retired from the Chief Judgeship and assumed status as a Senior Judge, it is most fitting to note the occasion and to acknowledge in somewhat summary fashion—there will be another time when we shall more fully express our gratitude to him—the enormous debt we all owe to Chief Judge Cowen and the great appreciation which the bench and the bar hold for his splendid service and leadership. I who have served throughout the period of his Chief Judgeship can attest, of my personal conviction and my personal knowledge, to his unexcelled leadership in all aspects of the court's functioning. It is hard to conceive how we could have gotten along nearly as well if he had not been at the helm since 1964. It is a marked understatement to say that he will be sorely missed as Chief Judge.

"Our sadness at his stepping down from the post of Chief Judge is mitigated in part by the welcome knowledge that he will stay with us as a judge. He has elected to be a Senior Judge and, as you can see this morning, he will continue to sit as much as he can. He is sitting today. That is the reason why there is this peculiar change of position in which I shall preside under the usual rule in our court that Senior Judges do not preside at court sessions. We welcome Judge Cowen in his new capacity and we are sure that he will serve in that status with the same extraordinary faithfulness and devotion that he has given to us, to the bar, and to the nation, for the last thirteen and a half years."

CASES DECIDED

IN

THE UNITED STATES COURT OF CLAIMS

FEBRUARY 1 TO APRIL 30, 1977, AND OTHER CASES NOT HERETOFORE PUBLISHED

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550 F.2d 1

TRI-STATE MATERIALS CORPORATION, LETART CORPORATION and THE BOWNEMONT CORPORATION v. THE UNITED STATES

[No. 119–73. Decided February 23, 1977]

ON PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

Eminent domain; taking; just compensation; flooding.—Plaintiffs seek just compensation for the alleged taking by the United States of their mining properties used in their sand and gravel extracting business. The United States constructed a lock and dam project on the Ohio River. In November 1969 defendant acquired title to a portion of plaintiffs' lands by condemnation for which they were awarded money judgments since the lands were to be permanently flooded upon completion of the project. The judgments expressly reserved plaintiffs' rights to recover for any damage done to their remaining property, i.e. the property which is the subject of this action. Since completion of the project the mining properties have been permanently flooded, the water table level rising from 538′ to 560′ mean sea level. To date the water table level remains at 560′. Defendant argues that natural water forces from non-Government sources have overcome and replaced Government floodwaters; that the 22′ of permanent flooding is not due to subflooding but due to blocking of drainage within the banks of the Ohio River, and that blocked drainage is a noncompensable taking; that the flooded mine is noncompensable because of the Government's navigational servitude; and that since the first 16′ of the rise is noncompensable, being the ordinary higher water level via the navigational servitude, the remaining 6′ caused *de minimis* damage. It is *held* that the 6′ damage issue is irrelevant if the initial 16′ of flooding is compensable when measured against the navigational servitude; that defendant's argument that natural water sources have replaced the original

Syllabus

Government floodwaters and that accordingly compensation is not required is without merit; that Government action creating a blocking of drainage resulting in permanent damage to plaintiffs is a compensable taking; and that the navigational servitude is not relevant to the facts of this case. Plaintiffs' motion for summary judgment is granted, and the case is remanded to the trial division for determination of damages under Rule 131(c).

Eminent domain; taking; what constitutes; flooding.

[1] Where Government dam construction causes permanent flooding of land of another, there is a Fifth Amendment taking for which the Government must pay compensation. This is so, whether such construction causes the permanent flooding by backing water upon the affected land or by causing the water table to rise to the point of impeding the land's previous uninhibited drainage.

Eminent Domain ⚖98

Eminent domain; nature and extent of power of Government; waters and watercourses; navigational servitude.

[2] The Government has the power to invade property rights in land within the bed of a stream, which includes all lands beyond the bed of the stream below the ordinary high water mark, without paying compensation when the purpose of the invasion is to aid in navigability of the stream. However, where the flooded lands in issue are not part of the bed of a navigable stream the lands are outside the normal scope of the navigational servitude, and where the value claimed to have been taken does not derive from access to or any riparian use of a navigable stream the servitude does not serve to limit the amount of damages.

Eminent Domain ⚖98

Eminent domain; just compensation; right to.

[3] Those who operate a mine within the bed of a navigable stream are on notice of the possibility of an invasion of their property rights by the Government and are subject to the navigational servitude; those beyond the limits of the bed are not subject to the navigational servitude and may recover just compensation.

Eminent Domain ⚖98

Eminent domain; taking; what constitutes; subflooding v. blockage of drainage.

[4] The law should, when possible, reflect a commonsense logic. Thus, where plaintiffs' mine is located beyond the limits of the bed of a navigable river and where the value claimed to have been taken by Government action which caused the water to rise above the water table resulting in permanent flooding does not derive from access to or use of the river, whether the invasion was subterranean flooding or subterranean blockage of drainage the deleterious effect was the same. For the law to glorify a semantical distinction to the extent of providing a remedy for subflooding and not for blockage of drainage is to promote form over substance and academics over commonsense. Natural drainage is a compensable riparian interest.

Eminent Domain ⚖98

John P. Arness, attorney of record for plaintiffs. *George W. Miller, Gail Starling Marshall, Dwight D. Meier*, and *Rudolph Janata*, of counsel.

Hubert M. Crean, with whom was *Assistant Attorney General Peter R. Taft*, for defendant.

Before SKELTON, KUNZIG, and BENNETT, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

This case, before us on plaintiffs' motion for summary judgment, presents a novel question. If the Government builds a dam with intent to enhance a waterway's navigability, and in so doing raises the water table of land lying outside its bed to a level where drainage is restricted and subterranean flooding results causing economic loss to the landowner, is the loss compensable as a Fifth Amendment taking?[1] While this question is rephrased in several ways by the parties herein, our answer to the generic question and to plaintiffs' request for summary judgment is in the affirmative.

This case also involves the complicated issue of the Government's navigational servitude—the sovereign's right to rule the navigable waterways of the land unimpeded by private ownership rights. A subject of much confusion, the extent of the Government's navigational servitude will hopefully be more clearly defined by this opinion.

The plaintiffs, Tri-State Materials Corporation, Letart Corporation and Bownemont Corporation, are the owners in fee of approximately 800 acres of land in Meigs County, Ohio. Since 1960, the plaintiffs have conducted a sand and gravel extracting business on part of the property. On November 7, 1969, defendant acquired title to a portion of plaintiffs' lands by condemnation, exercising the eminent domain statute, 46 Stat. 1421 (1931), 40 U.S.C. §258a (1970).

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[1] The facts of this case, as hereafter set out, pose a situation of first impression. While compensation has been allowed for damage caused by subterranean flooding to surface land beyond the bed of a navigable stream, we can find no case where the land *itself* was subterranean. In the instant case, the land was subterranean—a sand and gravel mine.

This land was taken pursuant to the defendant's construction of the Racine Locks and Dam Project (hereafter Project) in the Ohio River as the lands were to be permanently flooded upon completion of the Project. On March 2, 1972, the plaintiffs herein were granted money judgments in this condemnation action. The judgments included an express reservation by plaintiffs herein for any taking of or damage to any other lands of plaintiffs. This reservation included the mining properties, now the subject of this dispute, which were used in plaintiffs' sand and gravel extracting business.

Subsequent to the completion of the Project, the land in question subflooded. The water table level rose from 538 feet mean sea level (hereafter msl) before the Project's construction to 560 feet msl afterwards. This 22-foot raise in the ground water table has impaired the ease and profitability of extracting the sand and gravel from the mine. The extent of the impairment (alleged to be total by plaintiffs) is the subject of factual dispute and can be resolved by a trial judge in a separate determination. Ct.Cl. Rule 131(c). The issue before us is whether the impairment is compensable as a matter of law.

Although it is undisputed that the Government action precipitated the subflooding, the Government contends that this subflooding was only temporary. To this date, the water table level remains at 560 feet msl, but the Government argues that natural water forces from non-Government sources have overcome and replaced the Government floodwaters. Essentially, the Government is contending that "its water" has receded and been replaced by "other water."

The Government also says that the 22 feet of permanent flooding is not due to "sub-flooding", but due to "the blocking of drainage within the banks of the Ohio River," and that blocked drainage is a non-compensable taking.

The Government further argues that the flooded mine is non-compensable because of the existence of the Government's navigational servitude. The existence of the servitude preempts any right to subterranean drainage within the bed of a navigable river.

Defendant's alternative argument is very complicated. It appears to be as follows: Of the 22 foot raise in the water table (538 feet msl to 560 feet msl), the first 16 feet (538 feet msl to 554 feet msl; 554 feet msl being the ordinary high water line) is non-compensable by virtue of the exercise of the Government's navigational servitude. So, while the navigational servitude preempts recovery for blocked subterranean drainage within the bed of a navigable river (supra), says the Government, it also precludes recovery for a raise in the water table to the point of the ordinary high water mark.

As to the other six feet of water (the increment from the ordinary high water mark to 560 feet msl), defendant poses two theories. First, defendant asserts that the mining operation was already rendered worthless by the 16 feet of flooding (noncompensable by virtue of the navigational servitude). The extra six feet of water which is *not* protected by the navigational servitude, therefore, caused *de minimis* damages. Concisely stated, plaintiffs' mining operations became no more commercially impractical when the sand and gravel was submerged by 22 feet of water than when submerged by 16 feet of water. This argument has a logical appeal, and we find ourselves in agreement with defendant. Their syllogism is premised on the assumption that the initial 16 feet of flooding is noncompensable when measured against the navigational servitude. If the 16 feet of water *is* compensable, defendant's logic is equally appealing—the extra six feet would probably not significantly increase the impracticality of the mining operations. The question of damages for the last six feet of water table increase becomes then, for all practical purposes, irrelevant, and our focus must be upon the 16 feet issue.

Defendant's second theory concerning the six feet of flooding above the ordinary high water mark is that raising the water level above the ordinary high water mark is not compensable when the damage is a loss of ground water drainage. First of all, we have just determined that the damage issue for the six feet is irrelevant. Secondly, we see little difference between this argument and defendant's initial assertion that the mine was not destroyed by

subflooding, but by a lack of drainage and, therefore, is noncompensable. We now turn to defendant's initial assertion that the flooding is now caused by non-Governmental water and is thereby noncompensable.

The Government most adamantly asserts that the present flooding waters are not waters emanating from the Government source (the Racine Locks and Dam Project). It admits, however, that the original floodwaters were indeed its own. Those waters were "subsequently overcome by the natural water forces within the watershed of the subject lands." Defendant's Opposition to the Motion for Summary Judgment, p. 2. The Government has conducted many tests showing that the water currently flooding the mine did not originate from the Ohio River, but rather is water working towards the river from a higher elevation.

The Government's tests do little more than illustrate the normal gravitational displacement of water from higher sources to lower sources—from hills to streams to rivers and finally to the sea. Whereas prior to the raising of the water table, the gravitational flow of water would have occurred at a deeper subterranean level and not impaired the mining operations; the Project has raised the water table, resulting in the gravitational flow of water at a higher subterranean level, thus impairing the mining operations.

The Government asks us to adopt the proposition that compensation for the destruction of property resulting from subterranean flooding is not appropriate in this case, as only when the flooding is permanently caused by "Government water" is there a Government taking within the terms of the Fifth Amendment.

Emphasis upon whose water is currently flooding the mine is misplaced. This court has focused in the past on the permanent *effect* of Government action.

United States v. *Kansas City Life Ins. Co.*, 339 U.S. 799 (1950) affirmed by a 5–4 majority the holding of this court that a dam which raised the water table level causing underflooding of plaintiff's land, retarding the drainage rate of the land's surface and subsurface waters, and destroying it for agricultural purposes, was as compensable as a surface flooding would be. The Supreme Court found

in *Kansas City* that the land was permanently invaded by the percolation of waters from both the "Government water" (the river) and from "non-government water" (the tributaries). It said:

> The continuous presence of this raised water table also blocked the drainage of the surface and subsurface water in a manner which helped to destroy the productivity of the land. Whether the prevention of the use of the land for agricultural purposes was due to its invasion by the water from above or below, it was equally effective. (339 U.S. at 810)

This court made it clear in *Wilfong* v. *United States*, 202 Ct.Cl. 616, 622, 480 F.2d 1326, 1329 (1973), that the permanence of the *consequences* of the Government act is controlling, and there is no additional requirement that the *instrumentality* of the consequence be purely a governmental one:

> From these authorities [flooding cases] we extract the principle that to support a Fifth Amendment taking via inverse condemnation there must be not only a Federal activity or project which is permanent in nature, but that such activity or project must impose on private property certain consequences which are themselves permanent, and that their recurrence is inevitable even if only intermittent.

In the case at bar, the Project is certainly permanent in nature and the consequences—22 feet of subflooding—are permanent.

This court in *Goose Creek Hunting Club, Inc.* v. *United States*, 207 Ct.Cl. 323, 518 F.2d 579 (1975), further articulated the rule of *Kansas City:*

> [I]f an action taken by the Government to improve the navigability of a navigable stream raises the water level in the stream and thereby causes it to overflow or *otherwise damage* property situated *outside the bed* of such stream, the Government is liable for the ensuing damages. (207 Ct.Cl. at 331, 518 F.2d at 583) (emphasis added)

In the case at bar, the mine located outside the bed of the river was "otherwise damaged" by subflooding caused by a raised water table.

The defense asserted here by the Government is not only inconsistent with the *Kansas City* and *Goose Creek* cases, but was specifically rejected by this court in 1969 in *Fromme* v. *United States*, 188 Ct.Cl. 1112, 412 F.2d 1192 (1969). In *Fromme*, this court held for the Government after finding no permanency in the flooding complained of and that the plaintiffs' land would recover its economic value as grassland within two or three years. However, the court expressly stated that where Government construction causes permanent flooding of land of another, there is a taking for which the Government must pay compensation, and:

> . . . In this connection, it would seem to be immaterial whether works constructed by the Government cause the permanent flooding by backing water upon the affected land or by preventing water which originates elsewhere from draining off the affected land. (188 Ct.Cl. at 1118, 412 F.2d at 1196)

In the final analysis, then, it makes no difference whose water ultimately constitutes the flood waters. We need not answer the question left open in *Kansas City* as to Governmental liability for flooding where Governmental waters never invaded the subject lands, for here the water from the Ohio River did indeed comprise the initial floodwaters. If we look to the consequences of the Project in the case at bar, we see a but/for relationship to the permanent flooding. This is all that is required. In *Goose Creek*, the Government caused the water table to rise so as to disallow drainage of rain water. We held a compensable taking occurred. Viewing the facts here in the context of *Goose Creek*, the only difference in this case appears to be that the source of the subsurface flooding waters was runoff water from higher ground and not rain water. In both cases, Governmental action caused the water table to rise to the point of prohibiting the land's previous uninhibited drainage.

The above authorities also refute the Government's contention that Governmental action resulting in blocked or impeded drainage is noncompensable. *United States* v. *Kansas City Life Ins. Co., supra; Fromme* v. *United States*,

supra; Goose Creek Hunting Club, Inc. v. *United States, supra.*

We now turn to the Government's various contentions regarding the navigational servitude.

United States v. *Chicago, Milwaukee, St. Paul & Pacific R.R.*, 312 U.S. 592 (1941), provided the standard definition of the sovereign's navigational servitude. The Government was held to have the power to invade property rights in land within the bed of a stream (which includes all lands below the ordinary high water mark) without paying compensation when the purpose of the invasion was to aid in the navigability of the stream. *Accord, Oregon* v. *Corvallis Sand and Gravel Co.*, 429 U.S. 363 (1977).

Thus we do not believe that the navigational servitude is operational in this case for any of the reasons argued by the Government. Essentially, defendant places major reliance on just two issues, both of which we reject as follows: First, the lands at issue are not part of the bed of a navigable stream and are, therefore, outside the normal scope of the navigational servitude. Second, since the value claimed to have been taken does not derive from access to or use of a navigable stream, the navigational servitude does not serve to limit the amount of damages.

It is conceded by all parties that the land at issue in this litigation is "fast" land, that is, land beyond the bed of a navigable stream. The bed of a navigable stream includes the adjacent banks up to the ordinary high water mark. Land within the bed is always subject to (or burdened with) the potential exercise of the navigational servitude. An owner of such land may not claim compensation when the Government takes the land pursuant to aiding the navigability of the stream. *United States* v. *Chicago, Milwaukee, St. Paul & Pacific R.R., supra.*

Essentially, the Government is arguing the position put forth by the four dissenting Justices in *United States* v. *Kansas City Life Ins. Co.*, 339 U.S. 799 (1950). The dissent there challenged the validity of distinguishing between owners of land within the bed and owners of land outside the bed. The dissenters felt that the rule of the navigational servitude (and the corresponding rule of no compensation) should be applied to all landowners.

> It would be incongruous to deny compensation to owners adjacent to navigable rivers and require it for others bordering their tributaries for like injuries caused by the single act of lifting the river's mean level to the high-water mark. Because water seeks its own level, raising the level of the river necessarily raises that of the tributary at their conjunction and as far upstream on each as the effects of the lifting may go. These facts are equally apparent to both types of owners. We think they should be anticipated by both, and that the one has no more power to obstruct or burden the power of Congress in its control of the river's bed in the interest of navigation than the other. Neither has any greater right to have the river flow in its natural state than the other. (339 U.S. at 812)

We are, of course, bound by the majority opinion of the Supreme Court, and not by the dissent, despite certain logical appeal of Justice Douglas' words. We might comment, however, on Justice Douglas' premise that both sets of landowners can equally anticipate Governmental invasion by exercise of the navigational servitude. It seems unlikely that plaintiffs in this case could have anticipated such a direct impact. One who operates a mine within the bed of a navigable stream may assuredly be on notice of or anticipate a potential invasion, but one outside the bed, at least, has *less* notice or a lessened anticipation. As the distance from the bed increases, the notice and anticipation, it seems to us, would lessen proportionately. At some distant point from the river's bed, there would be no notice or anticipation of Governmental exercise of the navigational servitude. Rather than construct a rule which would require the court to determine the amount of compensation based upon the degree of subjective notice or anticipation of a Governmental invasion, and rather than construct a per se rule that *all* landowners be on notice and anticipate an invasion, the majority of the Supreme Court chose a middle, albeit imperfect, scheme of compensation. Those within the bed are subject to the navigational servitude and will not recover. Those beyond those limits are not subject to the navigational servitude and may recover.

Our second reason for holding the navigational servitude defense inapplicable to the case at bar is that the value

claimed to have been taken does not derive from access to or use of a navigational stream.

The Government attempts to fit the facts of this case into the mold of certain cases discussed in depth, *infra*.[2] In each of these "river cases," plaintiff had a riparian use or interest in the continued status quo of the stream. The riparian uses were held subordinate to the Government's navigational servitude. Essentially, the Government suggests that subterranean drainage is a riparian right, subordinate to the navigational servitude, and, therefore, Governmental blocking of subterranean drainage is a noncompensable invasion.

Once this argument is made, it becomes clear why the Government so adamantly seeks to distinguish between "subflooding" and "blockage of drainage." Not only do we think the distinction is a weak one, we believe that even if the distinction were accepted, the purview of the navigational servitude is not so broad as to preclude recovery for plaintiffs' damage in this case.

The law should, when possible, reflect a common sense logic. It defies common sense to differentiate between subflooding and blockage of drainage. They are one and the same. Any farmer recognizes that, as does any miner. For the law to glorify a semantical distinction to the extent of providing a remedy for one and not for the other is to promote form over substance, and academics over common sense.

A flood *is* a flood precisely because drainage is inadequate to allow adequate percolation in to subterranean resting places. The ground has achieved its maximum saturation point, and the water above ground can drain nowhere. Before a river overflows its banks, the water table rises. The ground below the river and to the sides of the river acts as a sponge, absorbing its full capacity of excess waters. When the flooding finally occurs, the water level beneath the surface of the adjoining lands has been

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[2] *United States* v. *Virginia Electric & Power Co.*, 365 U.S. 624 (1961); *United States* v. *Twin City Power Co.*, 350 U.S. 222 (1956); *United States* v. *Willow River Power Co.*, 324 U.S. 499 (1945); *Borough of Ford City* v. *United States*, 345 F.2d 645 (3rd Cir. 1965); *City of Demopolis, Alabama* v. *United States*, 167 Ct.Cl. 94, 334 F.2d 657 (1964); and *City of Eufala, Alabama* v. *United States*, 313 F.2d 745 (5th Cir. 1963).

raised. The drainage of the flood waters to the soil below is impeded by the existence of a raised water table. Were the water table lower, the flooding might be eliminated by virtue of the greater absorption potential. It is, therefore, possible to characterize the flood as not really being a flood at all, but merely a drainage problem. The concept is no different for subterranean flooding, which in this case was as deleterious to the mine as a surface flooding might be to a farm. We, therefore, find the Government's purported distinction to be ill-conceived and reject it.

Even if we were to concede that the distinction between subflooding and blocked drainage were proper, the Government does not succeed in enveloping the case at bar with the cases it cites.

We have earlier held that land such as plaintiffs' which is not part of the bed of the stream is not subject to the navigational servitude per se. However, where the property values and uses are *riparian*, the cases cited by the Government show that the value attributable to the access to or direct riparian use of the water is to be excluded from the compensation equation.

In *United States* v. *Willow River Power Co.*, 324 U.S. 499 (1945), plaintiff operated a hydroelectric plant on a nonnavigable stream, the Willow River, which ran close to its conjunction, the St. Croix River. When the Government built a dam on the Mississippi River into which the St. Croix flowed, the end result was a three-foot raise in the ordinary high water level at the plaintiff's property, reducing the hydroelectric facility's production. The Supreme Court disallowed a recovery, despite the fact that plaintiff's land was "fast land." The rationale of that decision seems to be that the right to the water itself for purposes of manufacturing power is subordinate to the navigational servitude, and noncompensable.

The facts and holding of *United States* v. *Twin City Power Co.*, 350 U.S. 222 (1956), are similar to those of *Willow River*. Again, the fast lands' value was claimed to be decreased by Governmental action altering the flow of a river. Plaintiff again had hydroelectric operations dependent upon the maintenance of the status quo of the river. The Court said:

> . . . the landowner here seeks a value *in the flow of the stream*, a value that inheres in the Government's servitude and one that under our decisions the Government can grant or withhold as it chooses. It is no answer to say that payment is sought only for the location value of the fast lands. That special location value is due to the flow of the stream; and if the United States were required to pay the judgments below, it would be compensating the landowner for the increment of value added to the fast lands if the flow of the stream were taken into account. (350 U.S. at 225–226; emphasis in original).

Basically, the Court's holding was that the flow of the river was subject to the navigational servitude and the owners of fast lands could not be awarded compensation *for their interest in that flow* if the Government caused the flow of the river to be altered. The Government had, in effect, provided the source and means for the hydroelectric plant's economic viability and could freely remove the source.

United States v. *Virginia Electric & Power Co.*, 365 U.S. 624 (1961), again involved a water power development, but the damage to plaintiff's property also included uses of the property not associated with the flow of the river. These non-riparian damages were held compensable, while the riparian uses were held noncompensable.

The three other cases cited by the Government, *Borough of Ford City* v. *United States*, 345 F.2d 645 (3rd Cir. 1965); *City of Demopolis, Alabama* v. *United States*, 167 Ct.Cl. 94, 334 F.2d 657 (1964); and *City of Eufala, Alabama* v. *United States*, 313 F.2d 745 (5th Cir. 1963), all deal with the taking of property used for sewer disposal involving direct use of the flow of navigational streams. Recovery was denied in each.

The unifying principle of these cases is that the only effect of the navigational servitude upon a claim for a taking of lands beyond the bed of the stream is to exclude the value attributable to the riparian uses of the navigable stream.

Unlike the three "power plant" cases and the three "sewer flow" cases, plaintiffs in the case at bar make no special riparian use of the navigable stream. They do not claim a loss for harm done to hydroelectric power

operations or artificial sewage flow. Nor do they claim a loss for any other riparian use such as, perhaps, fishing, irrigation, or use in a chemical plant's processes.

We fail to see how the enjoyment of the *natural drainage* of water into the earth and the gravitational flow of that water to a river and finally to sea is comparable with the *unnatural,* man-made uses of a river described by the six cases discussed above. The processes of natural drainage from plaintiffs' lands into the bed of the river have doubtless been present since the glaciers carved out the river basin. Plaintiffs never made *affirmative* use of the flow of the Ohio River. Drainage, like the air the miners breathed, had always existed for the entrepreneurs who founded the sand and gravel mine. The land in question was not chosen especially for the drainage value of the nearby river. Plaintiffs exercised no artificial riparian interest in the flow of the navigational servitude as did the plaintiffs in the cases cited by the Government. This, in combination with the fact that the lands lie beyond the boundaries of the Ohio River bed, takes the lands out from under the navigational servitude.

Therefore, even if we agreed to accept the Government's characterization of the damages in this case as being caused by blocked drainage and not subflooding, we cannot hold that natural drainage is a noncompensable riparian interest.

The Government contends that a decision for the plaintiffs in this case will cause irreparable harm to the Federal Government—that the navigational servitude will be gravely limited. We cannot agree. We believe that the facts of this case are relatively unique and that this opinion does not represent an unwarranted extension of *Kansas City* and *Goose Creek.* Our decision, in summary, is as follows:

Defendant's argument that natural water sources have replaced the original Governmental floodwaters and, therefore, compensation is not required must fail. *United States* v. *Kansas City Life Ins. Co., supra; Goose Creek Hunting Club, Inc.* v. *United States, supra; Fromme* v. *United States, supra.*

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By virtue of the same authorities, Governmental action creating a blockage of drainage is a compensable taking. The navigational servitude is not relevant to the facts of this case.

Accordingly, since there has been Governmental action in this case resulting in permanent damage to the plaintiffs, we grant the plaintiffs' motion for summary judgment and remand the case to the trial division for a determination of damages under Rule 131(c).

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551 F.2d 1201

QUARLES PETROLEUM COMPANY, INC. AND VIRGINIA TANK LINES, INC. v. THE UNITED STATES

[No. 428–75. Decided February 23, 1977]

ON DEFENDANT'S MOTION TO DISMISS, OR IN THE ALTERNATIVE FOR SUMMARY JUDGMENT AND PLAINTIFFS' CROSS-MOTION FOR SUMMARY JUDGMENT

Pollution control; recovery of oil spill clean-up costs for and on behalf of insurer-subrogee.—Plaintiffs, for and on behalf of their insurance carrier (Federated), seek to recover from the United States monies expended by Federated in cleaning up plaintiffs' oil spill. Plaintiffs are separate corporations with a common ownership. In February 1975 a truck owned by Virginia, carrying fuel oil owned by Quarles, overturned while trying to avoid collision with an automobile driven by a drunken driver. The tank was ruptured, allowing some 6,500 gallons of oil to spill into a navigable waterway of the United States. Plaintiffs immediately notified the Coast Guard and the United States Environmental Protection Agency and hired outside workers to contain and remove the oil. Federated, under the terms of the insurance contract, was obligated to pay oil spill clean-up expenses, which it did in individual checks made payable to the various cleaning crews. It is *held* (1) that plaintiffs satisfy the statutory requirements of Sec. 1321(i)(1) of the Federal Water Pollution Control Act, there being no indication in the legislative history of the Act, or its predecessor, that Congress intended to preclude recovery from the United States of oil spill removal costs when such costs, although paid out by the insurers on behalf of their clients, were incurred by the owner-operators of the oil discharging facility; (2) that an owner-operator may maintain a suit against the United States for and on behalf of its insurer, seeking recovery of the reasonable amount of the clean-up costs incurred by the

Syllabus

owner-operator; (3) that under the principles of subrogation of the insurer, the court will regard the suit solely as one maintained by the owner-operator for purposes of Sec. 1321(i)(1); (4) that the fourth element of the claim for relief is clarified to mean "expenditures by plaintiff [or its subrogee] of monies to remove the oil"; and [5] that since the discharge of oil was caused solely by an act or omission of a third party and since the removal costs were reasonable, plaintiffs are entitled to recover for and on behalf of Federated $10,133.45, and judgment is entered in this amount.

Water pollution; oil and hazardous substances liability; recovery of removal costs; elements of claim for relief.

[1] In order to recover costs of removing oil spills pursuant to the Federal Water Pollution Control Act, there must be (1) a discharge of a harmful quantity of oil from a facility owned or operated by plaintiff, (2) a discharge caused solely by * * * an act or omission of a third party, (3) removal of the oil in accordance with regulations, and (4) expenditure by plaintiff of monies to remove the oil.

Navigable Waters ⚖35

Pleading and practice; parties; insurer-subrogee.

[2] Although plaintiffs did not make their insurer a party to the present action to recover oil spill clean-up costs, since the insurer was obligated to pay plaintiffs' costs pursuant to the terms of the insurance contract and since the insurer's economic interest is actually at stake in the claim, it is deemed that plaintiffs are bringing the present action for the use and benefit of the insurer as subrogee.

Navigable Waters ⚖35

Water pollution; oil and hazardous substances liability; recovery of removal costs.

[3] The word "incur" as used in Sec. 1321(i)(1) of the Federal Water Pollution Control Act in respect of the recovery from the United States by an owner-operator of certain facilities from which oil has been discharged, of "the reasonable costs incurred in such removal," means to become liable for or subject to; it does not mean to actually pay for. Thus, where plaintiffs through their own actions were liable for costs resulting from the subject clean-up operations, their general manager negotiated assistance in such operations, and as a result plaintiffs were liable to pay for the same, the fact that plaintiffs were insured and that their insurer paid out the total costs of the clean-up is immaterial under Sec. 1321. Under such circumstances, plaintiffs satisfy the statutory requirements of Sec. 1321(i)(1).

Navigable Waters ⚖35

Claims against the United States; sovereign immunity, waiver of; generally.

[4] Statutes waiving the immunity of the United States must be strictly construed. But just as impelling is the duty of the Court of Claims to follow the intent of the Congress to make the United States fully liable to suit, and to accord every person, firm or corporation such right of

action when an enactment of the Congress is clear in its purpose to waive the sovereign immunity.

United States ⚷125(6)

Water pollution; oil and hazardous substances liability; recovery of removal costs; insurer-subrogee.

[5] Where the owner-operator of certain facilities from which oil has been discharged satisfies the jurisdictional limitations imposed by Sec. 1321(i)(1) of the Federal Water Pollution Control Act, a suit against the United States to recover clean-up costs by the owner-operator on behalf of his insurer who paid out the total costs of the clean-up, is within the intent of the Congress when it waived the immunity of the United States from suits in favor of the owner-operator. The Act does the same for the insurer whose claim is subrogated to the owner-operator; under the doctrine of subrogation, the insurer stands in the place of the owner-operator and recovers under Sec. 1321(i)(1) only if the latter is entitled to recover.

United States ⚷125(9)

Assignment of Claims Act; prohibition against assignment; recovery of oil spill clean-up costs; insurer-subrogee.

[6] Recognition of the application of the doctrine of subrogation of insurer in respect of recovery of oil spill clean-up costs by the owner-operator on behalf of his insurer-subrogee does not subvert the limitations of the anti-assignment part of the Assignment of Claims Act which applies to voluntary transfers, and not to assignments by operation of law such as subrogation.

United States ⚷111(8)

James H. Price, III, attorney of record, for plaintiff. *Browder, Russell, Little, Morris and Butcher,* of counsel.

Michael P. Carlton, with whom was *Assistant Attorney General Peter R. Taft,* for defendant. *Alfred T. Ghiorzi,* of counsel.

Before COWEN, *Chief Judge,* DAVIS and KASHIWA, *Judges.*

KASHIWA, *Judge,* delivered the opinion of the court:

This case is before this court on cross motions for summary judgment. Each party submitted its respective motion without oral argument. The pleadings and answers to interrogatories in this action show that there is no genuine issue as to any material fact. We hold for the plaintiffs and against the defendant.

Plaintiffs, Quarles Petroleum Company, Inc. ("Quarles") and Virginia Tank Lines, Inc. ("Virginia Tank") seek for

and on behalf of Federated Insurance Company ("Federated") to recover costs allegedly incurred in cleaning up an oil spill. The action is based exclusively upon Section 311(i)(1) of the Federal Water Pollution Control Act, codified at 33 U.S.C. §1321(i)(1).[1]

The following facts are not in dispute. Virginia Tank and Quarles are separate corporations with a common ownership. On February 1, 1975, a tank truck owned by Virginia Tank, carrying approximately 7,300 gallons of fuel oil owned by Quarles, was being driven by John Coryell Hayden, an employee of Virginia Tank, along U.S. Route 29 near Warrenton, Virginia. At approximately 1:30 a.m. on that day, Gordon N. Gill attempted to make a left turn in his automobile from the right-hand lane of Route 29 and turned into the path of the Virginia Tank truck. Hayden braked and turned his wheels to the right in an effort to avoid striking the automobile operated by Gill, but was unable to do so. The tank truck overturned and the tank ruptured, allowing approximately 6,500 gallons of oil to spill into Licking Run Creek, a navigable water of the United States within the meaning of the Federal Water Pollution Control Act. At the time of the accident it was raining and Hayden was traveling at a speed of approximately 50 m.p.h. (speed limit: 55 m.p.h.) with the tank truck lights and windshield wipers operating properly. The Virginia State Police accident report states that Gill was "Driving Drunk" at the time. For the purposes of this action, the parties agree that the discharge of oil into Licking Run Creek was caused solely by the act or omission of Gordon N. Gill.

Mr. William Crumpler, as General Manager of Virginia Tank, reported the oil spill to the United States Coast Guard and the United States Environmental Protection Agency on the morning of the accident. Various steps immediately were taken to contain and begin removal of the spilled oil, a task complicated by heavy snow and subsequent rain. For assistance in cleaning up the spilled oil, Mr. Crumpler contacted Petroleum Engineering Company, Inc. and Industrial Marine Service, Inc. The total

[1] 33 U.S.C. §1321(i)(1) (Supp. V, 1975).

cost of the clean up operations was $10,133.45, which the parties acknowledge is reasonable. Plaintiffs' insurer paid out the $10,133.45 in individual checks payable to the persons and companies which had provided goods or services in cleaning up the spilled oil.

The Federal Water Pollution Control Act provides that certain parties under certain circumstances may recover from the United States monies they have expended in removing oil spills from navigable waters of the United States. The statute, 33 U.S.C. §1321(i)(1), provides in pertinent part as follows:

Recovery of removal costs

(i)(1) In any case where an owner or operator of a vessel or an onshore facility or an offshore facility from which oil or a hazardous substance is discharged in violation of subsection (b)(3) of this section acts to remove such oil or substance in accordance with regulations promulgated pursuant to this section, such owner or operator shall be entitled to recover the reasonable costs incurred in such removal upon establishing, in a suit which may be brought against the United States Government in the United States Court of Claims, that such discharge was caused solely by (A) an act of God, (B) an act of war, (C) negligence on the part of the United States Government, or (D) an act or omission of a third party without regard to whether such act or omission was or was not negligent, or any combination of the foregoing causes.

As this court stated in *Yankee Metal Products, Inc.* v. *United States*, 209 Ct. Cl. 770 (1976), there are four separate elements of a claim for relief under this provision:

> (1) A discharge of a harmful quantity of oil from a facility owned or operated by plaintiff;
> (2) A discharge caused solely by * * * an act or omission of a third party;
> (3) Removal of the oil in accordance with regulations; and
> (4) Expenditure by plaintiff of monies to remove the oil.

As the facts in this action show, the plaintiffs have satisfied elements (1), (2) and (3). The issue before this court concerns element (4). Precisely, the issue is whether plaintiffs for and on behalf of their insurance company qualify under §1321(i)(1) to recover from the United States

costs of an oil spill clean up operation which costs were incurred by the plaintiffs but paid by the insurance company.

Plaintiffs admit that they initiated this suit for and on behalf of their insurance carrier, Federated, to recover from the United States the monies expended by Federated in removing plaintiffs' oil spill. Federated, as the insurer of the plaintiffs, was obligated to pay such expense and after payment became subrogated to the insureds' rights of action by the terms of the insurance contract. Although plaintiffs have not made Federated a party to this action, the record, including the briefs and exhibits filed by both parties, makes it clear that Federated's economic interest is actually at stake in this claim. Therefore, we deem that plaintiffs are bringing this action for the use and benefit of Federated Insurance Company.

The Government contends that the plaintiffs cannot prevail in this action because §1321(i)(1) by its terms and by decisions of this court[2] only allows recovery of clean up costs to an "owner or operator" of certain facilities from which oil is discharged; an insurer of such an owner or operator in its own name or in the name of its insured cannot recover clean up costs under this section. Specifically, defendant asserts that the plaintiffs have failed to show that they have expended any money in the clean up for which they must be reimbursed by the United States pursuant to §1321(i)(1), since plaintiffs' insurance company paid the entire $10,133.45. Insofar as it is not an "owner or operator" as required by statute,[3] defendant maintains that the insurance company is precluded from proceeding in its own name to recover the clean up costs. Concomitantly, the fact that this action for the benefit of the insurer is brought in the names of the insureds, the actual owner-operators, should not, defendant proposes, change

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[2] Defendant supports its contention by relying on this court's decisions in *Gulf Refining Co.* v. *United States*, 207 Ct.Cl. 971 (1975); *Shell Oil Co.* v. *United States*, 209 Ct. Cl. 699 (1976); *Celestial Navigation Corp.* v. *United States*, 209 Ct. Cl. 721 (1976); and *Yankee Metal Products, Inc.* v. *United States*, *supra*.

[3] For the purpose of §1321, owner or operator is, in the case of a motor vehicle, any person, including a corporation, owning or operating such vehicle. 33 U.S.C. §1321(a)(6)(B); (a)(7); and (a)(10).

the result. It is our belief that defendant's conclusion is not sound.

Defendant has not pointed to nor are we able to find any indication in the legislative history of the Federal Water Pollution Control Act Amendments of 1972, or its predecessor, that Congress intended to preclude recovery from the United States of oil spill removal costs under §1321(i)(1), when such costs, although paid out by the insurers on behalf of their clients, were incurred by the owner-operators of the oil discharging facility. This is true even though Congress was aware of the role that insurance companies played in the oil transportation business.[4] In addition, the defendant cites no case wherein the issue was decided that an insurer, as subrogee, may not recover under §1321(i)(1). Although the defendant directs this court's attention to our decision in *Yankee Metal Products, Inc.* v. *United States, supra,* we do not feel that our decision in that case provides guidance to decide the instant subrogation issue. The plaintiff in *Yankee Metal Products* did not recover under §1321(i)(1) because its petition did not allege that the spilled oil was discharged from a facility owned or operated by it. Furthermore, that plaintiff had not alleged the *amount* of expenses it incurred in the clean up operations; without a damage claim, this court could not act. The other cases, *Gulf Refining Co.* v. *United States, supra* note 2, *Shell Oil Co.* v. *United States, supra* note 2, and *Celestial Navigation Corp.* v. *United States, supra* note 2, cited by the defendant to support the proposition that an insurer, as subrogee, may not recover the monies outlayed in cleaning up spilled oil because it is not an "owner or operator" as required under §1321(i)(1), also do not help us to decide the instant subrogation issue. In fact, the factual situations and the legal issues before the court in each of the above cases are totally unrelated to the instant case.

Inasmuch as the record shows that the plaintiffs' insurance company paid the entire $10,133.45 which the plaintiffs seek to recover, defendant presumes that the plaintiffs, Quarles and Virginia Tank, have "failed to show

[4] The financial responsibility requirements imposed by 33 U.S.C. §1321(p) demonstrate Congressional awareness of the insurance carrier's role in the oil transportation field.

that they have incurred any costs in the clean-up, as required by statute." We disagree with the defendant. Section 1321(i)(1) speaks in terms of the owner-operator recovering from the United States "the reasonable costs *incurred* in such removal." To incur means to become liable for or subject to;[5] it does not mean to actually pay for. The facts in the instant case clearly demonstrate that the plaintiffs through their own actions were liable for the costs resulting from the clean up operations. It was the plaintiffs' general manager who negotiated assistance in cleaning up the spilled oil. As a result, the plaintiffs were liable to pay the persons and companies which had provided the goods and services in removing the spilled oil. The fact that the plaintiffs were insured and that the plaintiffs' insurer paid out the total cost of the clean up operations is immaterial under §1321. In our opinion, the plaintiffs, Quarles and Virginia Tank, satisfy the statutory requirements of §1321(i)(1). Nevertheless, the defendant next argues that jurisdictionally this court is still restricted from considering this action because the United States has not waived its sovereign immunity from suit by the insurance company or by the plaintiffs for and on behalf of their insurance company.

It is well established and readily admitted by this court that statutes waiving the immunity of the United States must be strictly construed.[6] But just as impelling is the duty of this court to follow the intent of the Congress to make the United States fully liable to suit, and to accord every person, firm or corporation such right of action when an enactment of the Congress is clear in its purpose to waive the sovereign immunity.[7]

A clearer waiver of immunity than that contained in 33 U.S.C. §1321(i)(1) is not easily phrased. Once the owner-operator satisfies the other jurisdictional limitations imposed by §1321(i)(1), "* * * suit * * * may be brought against the United States Government in the United States

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[5] Webster's Third New International Dictionary, 1971. *See also* Ballentine's Law Dictionary, Third Edition, 1969; and Black's Law Dictionary, Fourth Edition, 1968.

[6] *Schillinger* v. *United States*, 155 U.S. 163 (1894).

[7] *Tlingit & Haida Indians of Alaska* v. *United States*, 147 Ct. Cl. 315, 331, 177 F.Supp. 452, 462 (1959).

Court of Claims * * *." No intimation arises in this section to outlaw suit for and on behalf of a subrogee. As earlier mentioned, Congress was well aware of the import insurance carriers maintained in the oil transportation business. In addition, the overall intention of Congress in enactment of the Federal Water Pollution Control Act was to eliminate or to reduce as much as possible all water pollution throughout the United States. This court by restricting the application of §1321(i)(1) to non-insured owner-operators not only would hamper this overall concern of environmental purification, but would run afoul of the case law interpreting other federal statutes similarly silent on the right of subrogation.

The Federal Tort Claims Act[8] ("FTCA") is similar to the Federal Water Pollution Control Act in that both acts allow recovery against the United States for certain claims and both acts are silent in their terms on the issue of subrogation. Specifically, 28 U.S.C. §1346 (1970), providing exclusive jurisdiction in district courts under the FTCA, provides in pertinent part:

> (b) Subject to the provisions of Chapter 171 of this title, the district courts, * * * shall have exclusive jurisdiction of civil actions on claims against the United States, for money damages, accruing on and after January 1, 1945, for injury or loss of property, or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be liable to the *claimant* in accordance with the law of the place where the act or omission occurred. [Emphasis supplied.]

By its expressed terms, the above section permits recovery from the United States by only "the claimant"; the section does not include or preclude recovery by the subrogee of the claimant. Nevertheless, courts have allowed a subrogee of a claimant to recover against the United States under the FTCA. *United States* v. *Aetna Casualty & Surety Co.*, 338 U.S. 366 (1949); *United States* v. *United Services Automobile Association*, 238 F.2d 364 (8th Cir. 1956). The court in *United Services Automobile Association* stated:

[8] Codified in 28 U.S.C. §§1346, 2671–2680 (1970).

> An insurer has a right to sue under the Tort Claims Act on a claim to which it has become subrogated by payment to an insured who would have been able to bring such an action. [Citation omitted.] [238 F.2d at 366.]

With relation to the doctrine of sovereign immunity under the FTCA, the Court in *United States* v. *Yellow Cab Co.*, 340 U.S. 543, 547–48 (1951), stated:

> The Federal Tort Claims Act waives the Government's immunity from suit in sweeping language. It unquestionably waives it in favor of an injured person. It does the same for an insurer whose claim has been subrogated to his. [Citation omitted; footnote omitted.]

Neither the subrogation to the insurance carrier of the injured person's rights under the FTCA nor the doctrine of sovereign immunity has prevented the maintenance by the subrogated insurance company of a suit against the United States under the FTCA.

Other federal statutes silent on the right of subrogation are popularly known as the Suits in Admiralty Act[9] and the Public Vessels Act.[10] In neither statute is the right of subrogation expressly included or precluded; however, courts when faced with the problem of statutory construction have implied the right of subrogation under each statute.[11]

Notwithstanding the analogies to the Federal Tort Claims Act, the Suits in Admiralty Act and the Public Vessels Act, we see no reason not to permit an owner-operator to recover under §1321(i)(1) for and on behalf of its subrogated insurance carrier.

First, under the doctrine of subrogation of insurer, an insurer can take nothing by subrogation but the rights of the insured, and is subrogated to only such rights as the insured possesses. In such circumstances, the subrogee "stands in the place" of the insured and obtains equivalent but no greater rights than held by the insured. *Cf.*, *United States* v. *Munsey Trust Co.*, 332 U.S. 234, 242 (1947); *First*

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[9] 46 U.S.C. §§741–752 (1970).

[10] 46 U.S.C. §§781–790 (1970).

[11] *See Defense Supplies Corp.* v. *United States Lines Co.*, 148 F.2d 311 (2d Cir. 1945), and *United States Fidelity & Guaranty Co.* v. *United States*, 56 F.Supp. 452 (S.D.N.Y. 1944), *aff'd*, 152 F.2d 46 (2d Cir. 1945).

National City Bank v. *United States*, 212 Ct. Cl. 357, 369–70, 548 F. 2d 928, 936 (1977). As a result, Federated, as plaintiffs' subrogee, would recover under §1321(i)(1) only if plaintiffs, as owners-operators, would be entitled to recover. There would be no extension of liability or additional waiver of sovereign immunity against the United States by allowing a subrogee to recover through its insured owner-operator under §1321.

Second, to recognize subrogation under §1321(i)(1) would not subvert the limitations of the anti-assignment part of the Assignment of Claims Act, 31 U.S.C. §203 (1970). The statutory purposes of that legislation are to prevent fraud, control multiple litigation, and confine the Government's dealings to a very limited number of persons or entities. *United States* v. *Aetna Casualty & Surety Co.*, *supra* at 373; *United States* v. *Shannon*, 342 U.S. 288, 291–92 (1952); and *First National City Bank* v. *United States*, *supra* ,212 Ct. Cl. at 369–70, 548 F. 2d at 936. Moreover, that statute only applies to voluntary transfers, and not to assignments by operation of law such as subrogation. *United States* v. *Aetna Casualty & Surety Co.*, *supra*.

Third, to deny subrogation under §1321 may discourage insurance carriers either from writing policies covering those engaged in the oil transportation business or from writing policies covering oil spill removal operations. In either case, the general import of the Federal Water Pollution Control Act may be adversely affected.[12]

In conclusion, we are of the opinion that an owner-operator satisfying the other requirements under §1321(i)(1) may maintain a suit against the United States, for and on behalf of the owner-operator's subrogee, seeking recovery of the reasonable amount the owner-operator incurred in the oil spill removal operations. Where the owner-operator prosecutes a claim in its own name for and on behalf of its insurance carrier, under the principles of subrogation of the insurer, we will regard the suit solely as one maintained by the owner-operator for the purposes of §1321(i)(1).[13] The fourth requirement reiterated by this

[12] *See, e.g.*, 33 U.S.C. §1321(p).

[13] *Cf.*, *Owens-Corning Fiberglas Corp.* v. *United States*, 190 Ct. Cl. 211, 236, 419 F.2d 439, 453 (1969); *Merritt-Chapman & Scott Corp.* v. *United States*, 198 Ct. Cl. 223,

court in *Yankee Metal Products, Inc.* v. *United States, supra,* interpreting §1321(i)(1), is clarified by this decision to mean "Expenditures by plaintiff [or its subrogee] of monies to remove the oil."

CONCLUSION

The facts in the instant action clearly demonstrate that the plaintiffs, Quarles and Virginia Tank, have satisfied the requirements of §1321(i)(1), viz.: The plaintiffs incurred reasonable costs in removing a harmful quantity of oil which was discharged into navigable waters of the United States from a facility owned or operated by the plaintiffs and which discharge was caused solely by an act or omission of a third party. For the foregoing reasons, the court concludes that the plaintiffs are entitled to recover for and on behalf of Federated Insurance Company the $10,133.45 costs incurred by plaintiffs.

Accordingly, defendant's motion to dismiss the petition for failing to state a cause of action and defendant's motion for summary judgment are both denied; plaintiffs' cross motion for summary judgment is granted. Judgment is entered in favor of the plaintiffs for and on behalf of Federated Insurance Company in the amount of $10,133.45.

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550 F.2d 624

JON P. BRUINOOGE v. THE UNITED STATES

[No. 443–75. Decided February 23, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; income tax; exclusions from gross income; certain combat pay of members of the Armed Forces; constitutionality of classification; due process.—Plaintiff, a former Air Force captain who served in Vietnam, seeks refund of income taxes for years 1972 and

458 F.2d 42, 43 (1972); cases under the principles of contract privity where this court regards a suit prosecuted by a prime contractor for and on behalf of its subcontractor as one solely by the prime contractor.

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1973. He challenges the constitutionality of Sec. 112 of the Internal Revenue Code of 1954 which excludes from gross income of enlisted personnel and warrant officers all military compensation earned in a combat zone but limits the commissioned officers' exclusion to $500 per month. He contends that the statutory distinction between the two classes is so arbitrary and capricious that it denies him due process of law. It is *held* that Sec. 112 does not constitute a denial of plaintiff's right to due process of law; the classification is supported by a rational basis; and the statute does not create an arbitrary distinction between two classes of individuals unrelated to the objective of the statute to reduce taxes for those most in need of a tax benefit and on the other hand to raise revenue by limiting commissioned officers' exclusion. Defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed.

Constitutional law; equal protection of the law; generally.

[1] The Court of Claims recognizes that the Fifth Amendment, even though it contains no equal protection clause, forbids discrimination so unjustified as to deny due process.

Constitutional Law ⚖253(2)

Constitutional law; due process of law—Fifth Amendment; basis for classification.

[2] In determining whether a statute violates due process of law, the test is whether the classification of persons designated therein is reasonable, not arbitrary; the classification must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike. Thus, so long as there is some rational basis for the distinction, the statute is constitutional.

Constitutional Law ⚖253(2)

Constitutional law; due process of law—Fifth Amendment; taxation of income; gross income, exclusions from; combat pay of certain members of Armed Forces.

[3] The constitutionality of Sec. 112 of the Internal Revenue Code of 1954 in allegedly denying due process of law cannot be determined solely from the number of specific anomalies that occur in the system of military pay, for instance the higher pay received by some non-commissioned officers and warrant officers vis-à-vis some commissioned officers. Rather the court must look to whether Congress acted arbitrarily in treating commissioned officers differently. Classifications are not required to be perfect, to be made with mathematical nicety, or to avoid all inequality.

Constitutional Law ⚖286

Taxes; income tax; gross income, exclusions from; combat pay of certain members of Armed Forces; legislative intent.

[4] Sec. 112 of the Internal Revenue Code of 1954 reflects Congress' desire to grant a greater tax benefit to military personnel stationed in a combat zone whose incomes are smaller, and a smaller benefit to those whose incomes are greater. Congress may have balanced its urge to

dispense tax benefits to military personnel in a combat zone with the Treasury's need to raise revenue, especially during wartime, by concluding that officers, on the whole, were better able to bear a proportionally greater tax burden. This would be a constitutionally sufficient basis for the statute as enacted.

Internal Revenue ⇨28

Jon P. Bruinooge, Pro Se.

David C. Hickman, with whom was *Assistant Attorney General Scott P. Crampton,* for defendant. *Theodore D. Peyser* and *Robert S. Watkins,* of counsel.

Before COWEN, *Chief Judge,* DAVIS and NICHOLS, *Judges.*

NICHOLS, *Judge,* delivered the opinion of the court:

These cross-motions for summary judgment present no triable issue of relevant fact. Plaintiff, formerly a captain in the United States Air Force, challenges the constitutionality of section 112 of the Internal Revenue Code of 1954, which excludes from the gross income of enlisted personnel and warrant officers all of the military compensation they earn in a combat zone, but limits the commissioned officers' exclusion to $500 per month. For part of both 1972 and 1973, plaintiff served in Vietnam, designated a combat zone for the purposes of section 112 in Executive Order 11216, 3 C.F.R. 301 (1964–1965 Compilation), *reprinted in* 26 U.S.C.A. §112 (1965), and paid the tax prescribed for his monthly income in excess of $500. Now plaintiff seeks a refund of that tax, on the grounds that the statutory distinction between commissioned officers and other military personnel is so arbitrary and capricious that it denies him due process of law guaranteed by the fifth amendment. After the Internal Revenue Service denied his timely claim for refund, in which he had advanced the same grounds, plaintiff sued in this court. Plaintiff deserves our compliments for bearing the burden of raising this important question, and pursuing it so effectively. Despite plaintiff's forceful arguments, however, we conclude that the statute withstands the challenge. We must hold for defendant.

Plaintiff rests his claim that section 112 is unconstitutional solely on its alleged violation of the due process clause of the fourteenth amendment, which by its terms applies only to state legislation and not to the acts of Congress. Nevertheless, plaintiff points out that the doctrines our courts have developed for resolving equal protection questions have now been incorporated also into the notions of due process. *See, e.g., Schneider* v. *Rusk*, 377 U.S. 163 (1964); *Bolling* v. *Sharpe*, 347 U.S. 497 (1954). This point appears to have been settled in our court at least since we recognized that the fifth amendment, even though it contains no equal protection clause, forbids discrimination so unjustified as to deny due process. *Fredrick* v. *United States*, 205 Ct. Cl. 791, 796 n.1, 507 F.2d 1264, 1266 n.1 (1974). Accordingly, we should declare this statute unconstitutional if we conclude that the classification it establishes lacks any rational basis. In this connection, plaintiff refrains from contending that commissioned officers comprise a "suspect class" which would require that burdens imposed upon them satisfy a stricter standard of justification. One's becoming an officer, which normally is voluntary, is unlike those "immutable characteristic[s] determined solely by the accident of birth," that have given rise to the stricter standard. *Frontiero* v. *Richardson*, 411 U.S. 677, 686 (1973).

Because this case involves a constitutional challenge to a tax statute, the Government seems sometimes to urge us to apply a test even less demanding than the rational basis test. The Government relies on the Supreme Court's remark in *Brushaber* v. *Union Pacific R.R. Co.*, 240 U.S. 1, 24 (1916), that the exercise of the taxing power was constitutional unless it was so arbitrary or so grossly inequitable in its basis for classifying taxpayers that it must be regarded as confiscatory, within the fifth amendment meaning of a taking. It is unclear whether such a test, if it is in fact more lenient than the traditional test, still exists. At least, we are unaware that it has ever been invoked, for the Supreme Court has sustained discriminations in federal tax statutes that have been constitutionally challenged upon finding that a sufficient rational basis existed. There was no need to explore further. *See*

Maryland Savings-Share Insurance Corp. v. *United States*, 400 U.S. 4 (1970) (per curiam), and cases cited therein at p. 6. In our case, too, whether there exists a different constitutional standard for tax statutes is immaterial because the statutory distinction under attack is supported by a rational basis.

The course of our analysis has already been charted by our treatment of the issue presented in *Fredrick*, *supra*, which itself followed the Supreme Court's model, *Johnson* v. *Robison*, 415 U.S. 361 (1974). The plaintiff in *Fredrick*, a civilian War Department employee during World War II, challenged the constitutionality of the Veterans' Preference Act, 5 U.S.C. §§3501–02, which confers certain priorities in obtaining and keeping Government employment upon former military personnel. Our task there, as we stated it, was to determine whether the statute created an arbitrary distinction between two classes of persons that was unrelated to the objective of the statute. We echoed the now-familiar formula for such inquiries when we said, "The classification prescribed by the Act 'must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike.' " 205 Ct. Cl. at 797, 507 F.2d at 1266. We proceeded then to determine the reasonableness of the statutory classification by comparing the distinctions created with the statutory purpose. We were enlightened in *Fredrick* by the legislative history of the Veterans' Preference Act, which preserved for our review the sentiments of the Act's proponents. We suffer today from the absence of any enlightening committee report or debate over section 112. None has been cited by the parties or discovered in our own research. Congress has granted tax exemption for service men since 1945, that enactment being retroactive to 1941 for enlisted men and 1943 for commissioned and warrant officers. It has never treated these categories the same. *See* Revenue Act of 1945, Pub. L. No. 79–214, §141(a), 59 Stat. 556, 571; Revenue Act of 1950, Pub. L. No. 81–814, §202(a), 64 Stat. 906, 927. We cannot ascertain what Congress sought to accomplish by adding this provision to the tax code in 1945 and by its

later amendments. Yet, because our analysis requires that we try to divine what Congress left unstated, we resort to our own talents and those of counsel to discern what legitimate purpose Congress assigned to this statute, and then to test whether the less favorable treatment given commissioned officers bears a reasonable relationship to that purpose. While we rely on our own judgment in seeking out a legislative purpose, we are cautious lest we inadvertently evaluate the statute's effectiveness or the quality of its drafting. These matters are exclusively within the legislative realm; the Congress must be afforded considerable deference in this inquiry. So long as there is some rational basis for the distinction, the statute is constitutional. *Ferguson* v. *Skrupa*, 372 U.S. 726 (1963).

We are indebted to both parties, whose valuable briefs and able arguments offset considerably the absence of a legislative history. With obvious care and attention to detail, both sides have examined the statute and its effects in operation to better apprise us of what may, or may not, be its underlying purpose. The Government suggests that section 112 reflects Congress' desire to reduce taxes for those most in need of a tax benefit, namely, those below the grade of commissioned officer who, as a general matter, earn less than commissioned officers do. Plaintiff responds by pointing out that there are so many senior non-commissioned officers and warrant officers throughout the armed forces who received as much or more pay than some junior officers, that there is no reliable correlation between a taxpayer's rank and his income from which to fashion a rational basis for the statutory distinction. At this point, the parties quarrel over what statistical sample is appropriate to put this phenomenon in proper perspective. The Government argues that the number of warrant officers and enlisted personnel who actually earned more than plaintiff did not constitute more than one-tenth of one percent of the total military force. Plaintiff does not dispute this figure directly, but contends that its focus solely upon plaintiff's own situation is misleading. A more accurate measure of the discrimination created by section 112, plaintiff suggests, would result from determining how many non-commissioned personnel earn more pay than

any junior officer. Plaintiff tells us that 18 percent of the entire military force is in this category. We need not reconcile these arithmetic differences. The constitutionality of the statute at issue cannot be determined solely from the number of specific anomalies that occur in the system of military pay. *Cf. Craig* v. *Boren,* 429 U.S. 190, 199–209 n. 22 (1976), (demonstrating that statistical enumerations are of limited value in analyzing equal protection issues). We must look instead to whether Congress acted arbitrarily in treating commissioned officers differently. In balance, we think not. Even plaintiff's own calculations reveal that the pay received by an average officer—even one occupying the lowest pay grades as plaintiff contends is the most accurate basis for comparison—exceeds that received by either an average senior warrant officer or enlisted man. Classifications are not required to be perfect, to be made with mathematical nicety, or to avoid all inequality. *Dandridge* v. *Williams,* 397 U.S. 471, 485 (1970) and cases there cited. It appears that section 112 reflects Congress' desire to grant a greater tax benefit to those whose incomes are smaller, a smaller benefit to those whose incomes are greater. Distinctions among taxpayers on this ground were upheld in *Brushaber.* We notice, furthermore, that Congress did not altogether deny officers any income exclusion, but only limited their maximum exclusion to $500. Congress may have balanced its urge to dispense tax benefits to military personnel stationed in the combat zone, with the Treasury's need to raise revenue, especially during wartime, by concluding that officers, on the whole, were better able to bear a proportionally greater tax burden. We cannot deny that this would be a constitutionally sufficient basis for the statute as enacted.

The Government proposes another justification for section 112, which deserves our attention because it does not depend solely upon the differences in incomes. The Government suggests that the larger income exclusion made available to non-commissioned officers was to offset, in a general way, the prestige and the various privileges conferred solely upon officers. We would not be surprised to find, if we could look to a legislative history, that this sentiment may have been foremost in the Congressional

mind. Admittedly, one cannot identify what tangible and intangible advantages might have been the particular focus of Congress' concern for balance, or to correlate them precisely with rank. If we look at Title 10 of the U.S. Code, §8011 & *ff.*, the portion dealing with the Air Force, we find an array of provisions. Those dealing with personnel deal separately with officers and enlisted persons more often than not, by a superficial count. *E.g.*, Air Force officers are entitled to larger quarters than are enlisted personnel, 10 U.S.C. §9774. The Code of Military Justice specifies that enlisted men may be tried by courts martial comprised two-thirds of officers, but officers may be tried only by other officers. 10 U.S.C. §825.

We have not attempted to weigh all the burdens, rights and privileges of officers, and enlisted men, to see which way the balance inclines. The point is that the Congress may have done so. It may have thought a tax preference would make the overall balance more even. Plaintiff referred to the "up or out" promotion rule under 10 U.S.C. §8362 & *ff.*, 8846, as illustrating a burden on officers having no counterpart among enlisted men, including warrant officers. He did not attempt an analysis over all of the benefits and burdens, and it would exceed our cerebral powers to do so.

We take judicial notice that service in combat zones was more likely to be voluntary in the case of officers. In only a few special situations could a person be an officer subject to service in a combat zone, against his will. On the other hand, the enlisted components, in view of the draft, were likely in combat zones to be made up substantially of the unwilling. In the case of Vietnam specifically, repugnance to serving there in an enlisted capacity was widespread, while, among officers, it was frequently found that assignments to Vietnam were eagerly sought. It may be that, besides the stick of Selective Service, Congress thought that, for enlisted men, the carrot of a generous tax exemption was also necessary. With officers, the problems were of a different nature and required different measures for their solution.

Accordingly, upon the briefs and oral arguments of counsel, the defendant's motion for summary judgment is

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granted, the plaintiff's motion for summary judgment is denied, and the petition is dismissed.

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549 F.2d 1386

MICHAEL ROSKOS v. THE UNITED STATES

[No. 107–75. Decided February 23, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Civilian pay; validity of reassignment to non-commuting area; involuntary retirement; duress; reinstatement; Internal Revenue Service employee.—Plaintiff, a former GS–14 group supervisor with the Internal Revenue Service whose duty station for 21 years was Scranton, Pennsylvania, seeks back pay from the date of his retirement in June 1972 and for reinstatement to his supervisory position in Scranton, claiming that his retirement was involuntary resulting from calculated pressure amounting to duress. Plaintiff was notified of a proposed demotion to a non-supervisory position at GS–13 and of an immediate reassignment to Philadelphia at GS–13 because of alleged failure to report promptly information about improper conduct of subordinates. Plaintiff appealed and just prior to his hearing his superior modified the demotion to a 10-day suspension and simultaneously again reassigned plaintiff to Philadelphia to fill a non-supervisory GS–14 position. This mooted the hearing, but plaintiff filed a grievance protesting the suspension and second reassignment. While the grievance was pending plaintiff retired, stating that the reassignment to Philadelphia was hazardous to his health and a hardship to his family. On plaintiff's appeal of the agency decision reversing the suspension but holding the reassignment proper, and appeal also of the voluntariness of his retirement, the Civil Service Commission upheld the reassignment and held the retirement voluntary. It is *held* that the reassignment, coming right after and continuing the earlier transfer which was said to be premised on a different set of circumstances, was not valid as a discretionary managerial determination but was either an improper effort to pressure plaintiff to retire or was at the least an arbitrary and capricious adverse action. It follows that plaintiff's retirement must be characterized as involuntary since the reassignment represented an unjustifiable coercive action by the Government against plaintiff and left plaintiff with no practicable alternative in order to relieve the improper pressure on himself and his family. Plaintiff's motion for summary judgment is granted, defendant's cross-motion is denied, plaintiff is ordered reinstated in his pre-retirement and pre-reassign-

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ment position in Scranton, and is awarded back pay, the amount to be determined under Rule 131(c).

Court of Claims jurisdiction; generally.

[1] The jurisdiction of the Court of Claims under the Tucker Act is limited to money claims against the United States. Thus, although plaintiff's second reassignment to a non-commuting area was unjustified, since plaintiff's pay was not reduced by the transfer he has no monetary claim with respect thereto cognizable in this court.

Courts ⚖449(1)

Civilian pay; reassignment; validity of.

[2] Where a 10-day suspension was substituted for plaintiff's demotion in grade involving a change from group supervisor to a non-supervisory position and his immediate reassignment to a non-commuting area was again imposed along with the suspension, the second reassignment was not valid as a discretionary managerial determination to remove plaintiff from the company of persons whom he had previously supervised, particularly in the absence of evidence of an acceptable good-of-the-service rationale for requiring plaintiff to be reassigned immediately in a different job even though the demotion had been rescinded, and where a very much lighter penalty was substituted and the disciplinary proceeding was not yet final.

United States ⚖36

Duress; what constitutes.

[3] The elements constituting duress are that one side involuntarily accepted the terms of another, that circumstances permitted no other alternative, and that said circumstances were the result of coercive acts of the opposite party.

United States ⚖36

Civilian pay; Civil Service retirement; involuntary retirement; what constitutes.

[4] Where the court has determined that plaintiff's second reassignment to a non-commuting area was invalid and one which the agency had no lawful authority to command, plaintiff's decision to retire rather than impair his health and cause hardship to his family by the transfer was not a voluntary one and was directly caused by the reassignment. An action is not voluntary if it is produced by Government conduct which is wrongful.

United States ⚖36

Ronald E. Abramson, attorney of record, for plaintiff. *Hurwitz & Abramson*, of counsel.

Michael J. Rubin, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, DAVIS, and BENNETT, *Judges*.

DAVIS, *Judge*, delivered the opinion of the court:

In 1972, plaintiff Michael Roskos was a GS-14 employee who had served the Government for 37 years, 21 of them working for the Internal Revenue Service in Scranton, Pennsylvania. He had an excellent record with the IRS. On January 11, 1972, Roskos, then Group Supervisor of the Intelligence Division at Scranton, received notice of a proposed adverse action that he be demoted to a non-supervisory position at GS-13 and transferred at that lower grade to the IRS office in Philadelphia. This action was proposed because it was believed that he had failed to report promptly information about improper conduct of subordinates.[1] At the time that he received notice of this proposed adverse action, Roskos was also twice advised of his right to retire, even though he stated during the discussion that he had no current plans to do so. He was detailed to Philadelphia immediately.

Plaintiff appealed the proposed demotion and relocation but three days prior to a Civil Service Commission hearing scheduled for April 20, 1972, the IRS modified its action from a demotion to a 10-day suspension, and simultaneously reassigned Roskos back to Philadelphia to fill a non-supervisory position there at his old GS-14 grade level. This action effectively mooted the Commission hearing[2] but Roskos then filed a grievance within the agency, protesting the 10-day suspension and the second reassignment to Philadelphia. His superior determined that only the suspension was grievable, but in May 1972 the Washington IRS personnel director held the April reassignment contestable as well. On June 12, 1972, a grievance examiner was appointed to hear the case. A few days later, however, plaintiff retired, stating that his involuntary reassignment and transfer to Philadelphia was hazardous to his health and a hardship to his family.

Roskos' grievance proceeding continued after his retirement and ultimately the IRS Washington personnel office reversed the 10-day suspension but held that the reassign-

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[1] Failure to report employee misconduct is a violation of the Rules of Conduct for Internal Revenue Service Employees, subsection 1941.72 (revised 10/63).

[2] Plaintiff apparently received whatever may have been due him, in the way of back pay, for the period of his superseded demotion.

ment was a proper exercise of the district director's general authority over his personnel.[3] In September 1973, plaintiff appealed the Service's reassignment decision and the voluntariness of his retirement to the Civil Service Commission which, after investigating both the validity of the reassignment and the voluntariness of the retirement, decided that the reassignment was proper and the retirement voluntary.[4]

Plaintiff then sought review in this court, asking for back pay since his retirement and for reinstatement to his supervisory position in Scranton; his main claim is that his retirement was involuntary, the result of calculated pressure amounting to duress. Both sides have moved for summary judgment on the basis of the administrative record, and the case can be decided on what is now before us.

The focus of our consideration must be the voluntariness of plaintiff's retirement in June 1972. If that choice was freely made, he had no right after that event to further employment by the Federal Government—and the second (April) assignment to Philadelphia, although it may have been unjustifiable, would not in itself lead to a monetary claim cognizable in this court, even for the period from April to June 1972, since his pay was not reduced by that transfer.[5] At the same time, this court, like the Civil Service Commission, cannot escape taking account of the reassignments (and the other actions taken against plaintiff) in deciding whether his retirement was in fact voluntary. The conclusion of the Commission's Appeals Review Board that the retirement was voluntary rests almost entirely on its prior determination that the reassignments to Philadelphia were proper.

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[3] The reversal of the suspension was based on the recommendation of the grievance examiner who found, in February 1973, that the suspension was unreasonable because the evidence used to show that Roskos had violated the IRS Rules of Conduct was too questionable. Administrative Record, Part I, p.88.

[4] The Commission considered the reassignment only in connection with the employee's claim that his retirement had been involuntary; by itself the second reassignment, without loss of pay, would not be reviewable by the Commission after having been upheld within the agency.

[5] As already indicated, plaintiff has been compensated for loss of pay, if any, due to the two disciplinary actions which were altered or reversed within the Internal Revenue Service, *i.e.* the demotion from GS-14 to GS-13 and the 10-day suspension.

Plaintiff builds his case to prove that, from the very beginning of the adverse action proceeding in January 1972, his superior was intent on forcing his retirement, and that motivation was the spur to the continuing assignment to Philadelphia. We can refrain, however, from delving into that over-all position; we can assume *arguendo,* as the Commission held and the Government argues, that if Roskos was to be demoted from his supervisory position for a serious dereliction, it was good managerial practice to remove him both from the company of the persons he had previously supervised and from the geographic area in which he had held a leading role in tax criminal prosecutions. We can even assume for this case that the IRS acted in utter good faith when it first charged him (in January 1972) with the dereliction of failing to report misconduct, and determined to relieve him of supervisory duties, to demote him, and to remove him from Scranton tax affairs.

For us the crucial fact is that in April 1972 the superior who had charged and disciplined Roskos decided, on his own, that the penalty should be drastically lessened from a permanent demotion to a mere 10-day suspension, leaving plaintiff in his grade 14. Coming as it did after the initial imposition of a demotion, the minor penalty of a short suspension necessarily indicated that the dereliction, if it existed at all, was itself minor. We cannot believe that the levying of such a small sanction would have so compromised plaintiff with his subordinates or with the Scranton community that he had again to be immediately removed to a distant post in Philadelphia, even before his appeal could be processed.[6] Neither do we think that plaintiff's superior, after having so sharply reduced the penalty, could rationally make such a determination. Small violations invoking small sanctions, even at the supervisory level, do not normally trigger such a strong adverse reaction in the

[6] It should be recalled that (a) plaintiff had been working in Philadelphia ever since he had been charged in January 1972, first on detail and after the proposed demotion was made effective (in March) by formal transfer; and (b) when the demotion was reduced in April to a 10-day suspension, plaintiff's then transfer was rescinded but he was simultaneously retransferred to a different job in Philadelphia at the higher GS-14 level.

community or in the work-force as to warrant instantaneous exile or isolation.[7]

Plaintiff's superior has disavowed, as the defendant still does, any disciplinary taint to the April transfer, but we can find in the record no acceptable good-of-the-service rationale for requiring plaintiff to go back *instanter* to Philadelphia (in a different job from the one which he had filled since January) even though his demotion had been rescinded, a very much lighter penalty substituted, and the disciplinary proceeding was not yet final. Nor was there any other institutional or managerial reason for the April reassignment; the slot in the Philadelphia office in which Roskos was then placed had long been vacant and does not seem to have required any important or pressing work. The April transfer simply had no solid or substantial basis in personnel practice or principle.[8]

We must conclude, accordingly, that that reassignment, coming right after and continuing the earlier transfer which was said to be premised on a very different set of circumstances, was not valid as a discretionary managerial determination but was either an improper effort to pressure plaintiff to retire or was at the least an arbitrary and capricious adverse action. *Cf. Motto v. General Services Administration*, 335 F.Supp. 694 (E.D. La. 1971), *aff'd without opinion*, 502 F.2d 1165 (5th Cir. 1974), *cert. denied*, 420 U.S. 927 (1975); *Kletschka v. Driver*, 411 F.2d 436, 445-46 (2d Cir. 1969).

It follows, too, that Roskos' retirement in June 1972 must be characterized as involuntary. The ground he gave for the retirement was that the "involuntary reassignment and transfer to Philadelphia is hazardous to health and hardship to family," and there is no reason to doubt that

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[7] Although plaintiff's superior said at the Commission hearing that Roskos could not be effective in his old position any longer, he did not consult in April with any of plaintiff's coworkers or with community members to ascertain whether this suspicion was correct. Indeed, plaintiff submitted character letters on his behalf which indicate that several community members, including judges, a former U.S. Attorney and a fellow employee, felt that he should continue in his job in Scranton. *See also* note 8, *infra*.

[8] In upholding the transfer as proper, the Commission's Appeals Review Board did not separate out the earlier reassignment (based on the initial demotion) but erroneously carried over the reasons for that transfer to the April reassignment. There was no independent consideration by the Board of the April transfer.

explanation. Philadelphia was much too far from Scranton, where plaintiff had his family and his roots, for him to commute daily or otherwise than for the weekends. Unable to predict how long an appeal of his reassignment would take, Roskos could not well relocate his home and family. It was a hardship which had to be borne only if the April reassignment was proper. Because that reassignment was invalid rather than proper,[9] it represented an unjustifiable coercive action by the Government against plaintiff which, taken together with the fact that he was a family man, directly produced his retirement.[10] The case thus falls within the principle that a resignation or retirement is vitiated if it results from coercive acts of the Government which leave the employee with no practicable alternative.[11]

Of course, not every unpleasant working arrangement or distasteful set of alternatives constitutes duress or renders an otherwise voluntary act involuntary. *See, e.g., Christie v. United States,* 207 Ct. Cl. 333, 338, 518 F.2d 584, 587–88 (1975). But here the retirement was directly caused by the April assignment to Philadelphia which the IRS had no lawful authority to command. An action is not voluntary if it is produced by government conduct which is wrongful. *See Int. Tel. & Tel. Co. v. United States,* 206 Ct. Cl. 37, 52–53 (n. 11), 509 F.2d 541, 549–50 (1975); *Urban Plumbing & Heating Co. v. United States,* 187 Ct. Cl. 15, 29, 408 F.2d 382, 389 (1969), *cert. denied,* 398 U.S. 958 (1970); *Fruhauf*

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[9] We think that the IRS also violated plaintiff's rights when it detailed him to Philadelphia during the 30-day notice period following service of the letter of charges in January 1972. The Civil Service Commission regulations call upon the employing agency to retain the charged employee in his regular position during the notice period—if that is at all practicable and there is no emergency. 5 CFR 752.202(d); FPM Supp. S5–4a. The charge made against plaintiff in January 1972 does not seem to us to warrant, even assuming that the agency was acting in good faith, his being sent at once to Philadelphia.

[10] The Federal Personnel Manual Supp. 752–1 Subch. S1, 2a(1), declares that "whether an action is voluntary or involuntary is determined not by the form of the action but the circumstances that produced it."

[11] *See, McGucken v. United States,* 187 Ct. Cl. 284, 289, 407 F.2d 1349, 1351, *cert. denied,* 396 U.S. 894 (1969); *Fruhauf Southwest Garment Co. v. United States,* 126 Ct. Cl. 51, 62, 111 F.Supp. 945, 951 (1953). As the court has stated, the three elements necessary to show duress are: (1) that one side involuntarily accepted the terms of another; (2) that circumstances permitted no other alternative; and (3) that said circumstances were the result of coercive acts of the opposite party.

Southwest Garment Co. v. United States, supra, 126 Ct. Cl. 51, 62, 111 F.Supp. 945, 951 (1953).[12]

Our conclusion that plaintiff's retirement was wrongly coerced is not negated by his failure to claim expressly, at the time he filed his retirement application in June 1972, that he was retiring involuntarily. He did mention the involuntary nature of the reassignment and the hardship it caused; and six weeks later (in August 1972) he put forth at his grievance hearing an explicit claim that the retirement itself was involuntary. That August notice was prompt enough so as neither to prejudice defendant nor to tag the claim of coercion as a mere afterthought. Similarly, it is relatively unimportant that he may never have specifically protested to his superiors (before June 1972) that the reassignment was a hardship; they knew that he kept protesting the transfer, did not like it, and that he considered it illegal. Nor are we put off by the fact that he applied for retirement just a few days after the IRS had designated an examiner to hear his grievance. He had been directed to work in Philadelphia ever since January 1972; his Civil Service Commission appeal from the initial demotion and reassignment had been mooted in April by the IRS's reduction in the penalty to a 10-day suspension; that caused a substantial delay in the effort to clear his name. There had been some further delay in obtaining review through the IRS grievance procedure because his superior deemed the April reassignment not to be within that procedure, and this ruling had to be reversed by the national office. Above all, Roskos had no real notion how much more time would elapse before his appeal within the agency could be finally decided. Faced as he was with a continuing wrongful transfer to Philadelphia, he did not have to wait indefinitely before trying to relieve the improper pressure on himself and his family.

For these reasons, plaintiff's motion for summary judgment is granted and defendant's motion is denied. Plaintiff is ordered reinstated to his pre-retirement and pre-

[12] Though it found both reassignments proper, the Appeals Review Board seemed to agree that, if the April transfer was improper, the retirement would not have been voluntary.

reassignment position in Scranton, and awarded back pay, the amount to be determined under Rule 131(c).

BENNETT, *Judge*, concurring:

I accept the cogent reasons advanced by the court to support plaintiff's recovery. However, I feel that it has overlooked an additional viable reason therefor and perhaps miscontrued, but with no ultimate detriment here to plaintiff, the effect of his agency's backing down in April 1972 from its January 1972 adverse action in reducing plaintiff's grade. The court says that this retreat mooted the appeal from the action. Not so. Defendant's April transfer of plaintiff at a reduced *rank* was only a reaffirmation of what defendant proposed in January and which it did not at any time back away from. The reduction in rank is just as much of an adverse action as a reduction in grade and pay. It therefore entitles an employee to all procedural rights flowing therefrom regardless of the fact that his grade and salary are not reduced. These rights were not accorded to plaintiff.

The pertinent statute is 5 U.S.C. §7511 (1970), which states:

> (2) "adverse action" means a removal, suspension for more than 30 days, furlough without pay, or reduction in rank or pay.

Here is what the Federal Personnel Manual has to say on the subject of rank and grade at FPM Supp. 752–1, Subch. S2(2) (1966) (now Subch. S1-4 (1976)):

> The term *rank* * * * has been held by the Commission and by the courts to mean something more than grade * * *. Basically, it means an employee's relative standing in the agency's organizational structure, as determined by his official position assignment * * *. When an employee is made the subject of a personnel action which results in a lowering of his relative standing in the agency's organizational structure, then, a reduction in rank has occurred, even though the employee has not been reduced in grade. * * *.

The uncontested fact here is that on April 17, 1972, plaintiff was reassigned from his GS-14 position as a

supervisory criminal investigator (group supervisor of the Intelligence Division of the IRS, Scranton) to a GS-14 position as a criminal investigator (staff assistant) in Philadelphia. In his Scranton position plaintiff was responsible for the work of from 12 to 16 men who investigated tax fraud cases. These were all high-level employees, classified as high as GS-13. The supervisor's position was one of importance, respect and heavy responsibility. The Philadelphia position, by contrast, was nonsupervisory and its duties were of a clerical nature with little serious responsibility. In fact the position had long been left vacant. The Philadelphia position entailed such tasks as checking on the work of typists, summarizing the reports of group supervisors, and developing orders for equipment and keeping it safe. These are duties of a low-grade clerk, and the fact that the position carried a high grade and salary in plaintiff's case (GS-14) does not make it otherwise. It is plain that plaintiff's "relative standing in the agency's organizational structure" went down drastically when he assumed the position to which he was transferred in Philadelphia. This, then, was a reduction in rank and an adverse action against plaintiff according to law.

It is uncontested here that a preference eligible against whom an adverse action is proposed is entitled to at least 30 days advance written notice thereof, a reasonable time to answer personally and in writing and to furnish affidavits, a notice of an adverse decision, and must be kept in his regular position during the notice period, if at all practicable. 5 U.S.C. §7512(b) (1970), FPM Supp. 752–1, Subch. S5–4a (1966), 5 C.F.R. §752.202(d) (1971). Plaintiff was denied these safeguards to his rank. It is hard to imagine a more flagrant disregard of procedural due process explicitly provided for by statute and regulation. We do what we can to correct the error by reinstating plaintiff and giving him back pay.

By order of July 12, 1977, the court entered judgment for plaintiff for $133,781.35 out of which the General Accounting Office is authorized to credit $99,680 to the appropriate Civil Service annuity retirement fund with the balance of

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$34,101.35 to be paid to plaintiff. Plaintiff is further to be credited with 1,565 hours of accrued annual leave and 484 hours of accrued sick leave in addition to the 1,598 hours accrued by him as of July 1, 1972, for use or accrual to termination of his employment.

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550 F.2d 9

ELLIS FIRST NATIONAL BANK OF BRADENTON, AS EXECUTOR, ESTATE OF JOHN A. KERR, DECEASED v. THE UNITED STATES

[No. 348–75. Decided February 23, 1977. Plaintiff's motion to modify judgment denied April 1, 1977.]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; estate tax; charitable remainder interests; Tax Reform Act of 1969.—This is a suit to recover an amount, plus interest, representing an additional tax payment resulting from disallowance of a deduction claimed in an estate tax return filed December 15, 1971 for the value of certain charitable remainder interests created by a testamentary trust. Decedent died March 11, 1971. Decedent's last will and testament dated December 1, 1970, while repeating many of the terms of an earlier will executed June 6, 1969, expressly revoked all previous wills. Both wills established a traditional trust leaving a life income interest in various properties, including life estates in two residences, to decedent's sister; and upon her death the trust provided for a number of specific legacies, with distribution of the residuary estate to certain religious and charitable organizations. The Internal Revenue Service determined that the claimed deduction did not meet the requirements of Sec. 2055(e) of the Code, as amended by the Tax Reform Act of 1969. Plaintiff contends that the changes effected by the 1969 Act are not applicable to the estate because the will falls within the purview of the exceptions afforded by Sec. 201(g)(4)(B)(i) of the Act; however, if the Act does apply, plaintiff concedes the nondeductibility of all remainder interests passed under the trust except the remainder interests in the residences, as to which plaintiff says the Act creates an exception. Plaintiff also contends that Sec. 2055(e) permits a deduction for the charitable remainder interests in the residences in trust even though these interests were not left in one of the Act's approved trusts because Sec. 2055(e)(1) and (2) make reference to transfers to or "for a use." It is *held* (1) that the estate is covered by Sec. 2055(e) as amended by the Act, and that the deductions for the charitable remainder interests, including the residences, were properly disallowed; (2) that a review of the Senate

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legislative history of Sec. 2055(e) supports the rule announced in 26 C.F.R. § 20.2055–2(e)(ii) respecting charitable remainder interests in personal residences, not in trust - Sec. 2055(e) allows a deduction only for an outright gift of a remainder interest in a residence or farm and not one in trust. Plaintiff is not entitled to a refund of the taxes paid as a result of disallowance of the deductions. Defendant's motion for summary judgment is granted, except that plaintiff is entitled to an additional tax deduction for the costs incurred in this action, including reasonable attorney's fees; otherwise plaintiff's cross-motion is denied. The case is remanded to the trial division for determination of the amount of said deduction for costs and the amount of tax refund due plaintiff on account thereof.

Taxes; estate tax; taxable estate; transfers for public, charitable and religious uses; doctrine of dependent relative revocation.

[1] Although decedent's last will executed in December 1970 repeated the trust terms and charitable remainder interests provided in a nonprobated will executed June 6, 1969, the 1970 will was valid and expressly revoked all previous wills. Therefore, the doctrine of dependent relative revocation is irrelevant and the 1969 will had no effect on the estate.

Wills ⚖181, 189

Taxes; statutes; construction and operation; legislative intent; transfers for public, charitable and religious uses; Tax Reform Act of 1969.

[2] Congress, recognizing that there had been abuses in deductions taken for charitable remainder interests, narrowed the kind of trust device which could give rise to deductions; the restriction created was reasonably designed to further the congressional intent.

Internal Revenue ⚖1009

Taxes; estate tax; taxable estate; transfers for public, charitable and religious uses; Tax Reform Act of 1969; effective date; exceptions.

[3] Assuming the legal identity of the charitable remainder interests provided in decedent's revoked 1969 will and in his valid 1970 will, to the extent that the 1970 will repeated the provisions of the 1969 will it republished them after the October 9, 1969 date prescribed in Sec. 201(g)(4)(B)(1) of the Tax Reform Act of 1969. Congress did not intend to give relief where decedent had an opportunity to redraft his will with due regard to the changes resulting from the Act.

Internal Revenue ⚖1009

Taxes; Treasury regulations; construction and operation; generally.

[4] Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes; they constitute contemporaneous constructions by those charged with administration of the statutes and should not be overruled except for weighty reasons. (*Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501 (1948)). Where there is doubt as to the meaning of the statutory language, recourse to the legislative history may be necessary.

Internal Revenue ⚖151

Taxes; estate tax; taxable estate; transfers for public, charitable and religious uses; transfers not exclusively for charitable purposes; remainder interest in personal residence, deductibility of.

[5] The addition of the words "not in trust" in 26 C.F.R. § 20.2055–2 is in accord with the intent of Congress in enacting Sec. 2055(e) of the Code, as amended by the Tax Reform Act of 1969, to eliminate possible abuses in the administration of trusts which might operate to deprive a charity of future remainder interests for which the estate has been credited with a deduction. This concern is no less present with respect to personal residences or farms which pass first through a trust not approved by the Act. Accordingly, Sec. 2055(e) allows a deduction only for an outright gift of a remainder interest in a residence or farm, i.e. one not in trust.

Internal Revenue ⚖1009

Frank P. Riggs, attorney of record for plaintiff.

Evelyn Leopold, with whom was *Assistant Attorney General Scott P. Crampton,* for defendant. *Theodore D. Peyser, Donald H. Olson* and *Rose Anne Featherston,* of counsel.

Before COWEN, *Chief Judge,* DAVIS and KASHIWA, *Judges.*

COWEN, *Chief Judge,* delivered the opinion of the court:

Plaintiff, the executor and trustee under the will of John A. Kerr, seeks to recover the sum of $37,917.79 plus interest; this amount represents the additional tax resulting from the disallowance of a deduction of $152,279.36 claimed in an estate tax return for certain charitable remainder interests created in the will of John A. Kerr. The Internal Revenue Service determined that the claimed deduction did not meet the requirements of section 2055(e) of the Internal Revenue Code of 1954, as amended by the Tax Reform Act of 1969 (Act), Pub. L. 91–172, 83 Stat. 487. Although plaintiff has advanced appealing equitable arguments for recovery, we hold that the disallowance by the Internal Revenue Service was correct and dismiss plaintiff's petition.

I.

John A. Kerr died testate on March 11, 1971. His last will and testament, dated December 3, 1970, was admitted

to probate in the state of Florida, the domicile of the decedent, and administration of the estate proceeded in accordance with the terms of that will. The 1970 will repeated many of the terms of an earlier will executed on June 6, 1969. However, the 1970 will contained the customary clause "revoking all Wills and testamentary papers at any time heretofore made by me" and was the only will admitted to probate. The 1970 will was written and executed under emergency circumstances, a fact which is indicated in its inartful drafting.

By the terms of the 1970 will, a trust was established which left a life income interest in various properties, including life estates in two residences, to the decedent's sister, Hazel C. Kerr. Upon the death of the sister, the trust provided for a number of specific legacies, with the distribution of the residuary estate to certain designated religious and charitable organizations. The estate tax return was filed December 15, 1971, and as previously stated, a deduction was claimed for the value of the bequests of the remainder interests to charities; of the $152,279.36 deduction claimed, $42,740 was attributed to the value of the remainder interests in the residences.

Recognizing the possible invalidity of the deduction in the light of the Act, plaintiff, as executor of the estate, attempted to preempt any controversy and conserve the deduction by judicial reformation of the trust. However, the income beneficiary, then in her late 70's, would not agree, and the executor abandoned the reformation suit as futile.

Plaintiff contends that the changes wrought by the Act are not applicable to this estate. If the Act does apply, plaintiff concedes the nondeductibility of all remainder interests passed under the trust, except the remainder interests in the residences, with respect to which plaintiff argues that the Act creates an exception. We will first consider the applicability of the Act to this estate and thereafter plaintiff's interpretation of its provisions with regard to the residences.

II.

Among the many reforms provided, section 201(d)(1) of the Act, codified as section 2055(e) of the Internal Revenue Code of 1954 (26 U.S.C.), sought to rectify some of the abuses inherent in the then availability of estate tax deductions for charitable interest remainders. This objective is clearly set forth in H. Rep. No. 91–413 (Part 1), 91st Cong. 1st Sess.; 1969–3 C.B. 200, 237:

> *General reasons for change.*—The rules of present law for determining the amount of a charitable contribution deduction in the case of gifts of remainder interests in trust do not necessarily have any relation to the value of the benefit which the charity receives. This is because the trust assets may be invested in a manner so as to maximize the income interest with the result that there is little relation between the interest assumptions used in calculating present values and the amount received by the charity. For example, the trust corpus can be invested in high-income, high-risk assets. This enhances the value of the income interest but decreases the value of the charity's remainder interest.

The Act altered section 2055(e) to allow deductions only for those charitable remainders left in a manner which would provide adequate assurance that the remainder interest would be realized by the charity. It provided:

> §2055. Transfers for public, charitable, and religious uses
>
> * * * * *
>
> (e) Disallowance of deductions in certain cases.—
>
> (1) No deduction shall be allowed under this section for a transfer to or for the use of an organization or trust described in section 508(d) or 4948(c)(4) subject to the conditions specified in such sections.
>
> (2) Where an interest in property (other than a remainder interest in a personal residence or farm or an undivided portion of the decedent's entire interest in property) passes or has passed from the decedent to a person, or for a use, described in subsection (a), and an interest (other than an interest which is extinguished upon the decedent's death) in the same property passes or has passed (for less than an adequate and full consideration in money or money's

worth) from the decedent to a person, or for a use, not described in subsection (a), no deduction shall be allowed under this section for the interest which passes or has passed to the person, or for the use, described in subsection (a) unless—

A. in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664) or a pooled income fund (described in section 642(c)(5)), * * *.

It is uncontested that the trust created in John A. Kerr's will is not one of the Act's approved devices, *i.e.*, a charitable remainder annuity trust, a charitable remainder unitrust, or a pooled income fund. Rather, the will sets up a traditional trust whereby the life beneficiary receives the net income from the investment of the corpus made in the discretion of the trustee.

Plaintiff's sole argument to refute the applicability of the Act is that the will of John A. Kerr falls within the purview of the exceptions afforded by section 201(g)(4)(B)(i) which provides:

(g) Effective Dates.—

(1)(A) Except as provided in subparagraphs (B) and (C), the amendments made by subsection (a) shall apply to taxable years beginning after December 31, 1969.

* * * * *

(B) Such amendments shall not apply in the case of property passing under the terms of a will executed on or before October 9, 1969—

(i) if the decedent dies before October 9, 1972, without having republished the will after October 9, 1969, by codicil or otherwise, * * *.

Since plaintiff's estate tax return was filed in 1971, the estate is within the coverage of the Act unless: (1) the decedent died prior to October 9, 1972, which is the case here; (2) the property passed under the terms of a will executed on or before October 9, 1969, and (3) such will was not republished after October 9, 1969.

Plaintiff asserts that the effective dispositive instrument was the 1969 will, even though it was never admitted to

probate; this is allegedly so since the 1970 will merely repeated the trust terms and consequent charitable remainder interests provided in the 1969 will. Despite the fact that the 1970 will expressly revoked all previous wills, plaintiff argues that the 1969 provisions relating to the charitable remainder interests remained intact and hence were not factually revoked in any way. In support of this proposition, plaintiff has contorted the doctrine of dependent relative revocation[1] to breathe vitality into the 1969 will and accord it a significance which it did not have under Florida law in the distribution of this estate.

Briefly stated, this doctrine provides that the destruction, cancellation, or revocation of an earlier will is conditioned, according to a judicially assumed intention of the testator, on the "validity" of the later will. If the later will fails for any reason, the court presumes that the testator would not have revoked the earlier will given this eventuality. Thus, the earlier will is "admitted to probate" as the effective dispositive instrument. Cf. *In Re Kaufman's Estate*, 155 P.2d 831 (Sup. Ct. of Calif. 1945) and *Linkins* v. *Protestant Episcopal Cathedral Found.*, 187 F.2d 357 (D.C. Cir. 1950) on which plaintiff relies.

The doctrine is totally irrelevant to this case. Here, the second will—the 1970 will—was *valid;* therefore, to the extent that its revocation of the 1969 will was conditional, that condition was met. We are aware of no authority which has broadened this doctrine to encompass not only the condition of the later will's validity, but also to condition the revocation on a showing that the later will is entitled to a more beneficial tax treatment. Moreover, the purpose of the doctrine is to admit the first conditionally revoked will to probate. Here, only the 1970 will was admitted to probate. The 1969 will had no effect on this estate.

Plaintiff has advanced other diffuse attacks on the statutory scheme, labeling it as arbitrary and hastily conceived; we do not find it so. Congress recognized that there had been abuses in deductions taken for charitable

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[1] For an excellent discussion of the doctrine, see T. ATKINSON, HANDBOOK OF THE LAW OF WILLS (2d ed. 1953), pp. 452–63 [hereinafter cited as ATKINSON].

remainder interests and rectified the situation by narrowing the kind of trust devices which would give rise to the deductions. While none of the abuses which the Act aimed to eliminate may have been factually present in this particular estate, the restriction created was reasonably designed to forestall potential abuses. It is unfortunate for plaintiff's position that decedent's will was not redrawn in 1970 in accordance with the law then in effect, but the failure to change the will is not susceptible to remedy by judicial decision which would ignore the Act's plain meaning.

The 1970 will absolutely revoked the 1969 will. Assuming, for argument's sake, however, that plaintiff's strenuous arguments as to the legal identity between the 1969 and 1970 wills are valid, it is clear that plaintiff has failed to meet the third requirement of the section 201(g)(4)(B)(i) exception, *i.e.*, by proving that decedent died without having republished the will after October 9, 1969. To the extent the 1970 will parroted the provisions of the 1969 will, it republished them after the statutory date. The concept of "republication" arises in many areas of the law of wills:

> * * * Republication has been used to include the following: (1) The validation of a prior invalid will; (2) the revival of an instrument which has somehow lost its validity; (3) *the reaffirmance or bringing down to date of a will by codicil or later will;* (4) the restoration of a first will by the revocation of a second which had revoked the first. * * * (ATKINSON, *supra*, p. 464, emphasis added.)

It is the third category which is pertinent, namely, that the 1970 will brought down to date and reaffirmed the 1969 will. The section 201(g)(4)(B)(i) exception was added to grant relief in instances where testators died shortly after the statute's enactment without executing a new will or who were deprived of an opportunity to change an old will to conform to the changes in the tax laws. Congress considered that it would be unfair to apply the Act's new provisions to these testators.[2] However, it is clear that

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[2] The initial House version of the Act did not provide for so liberal a transition period before the Act was applicable to all estates. This was altered in the Senate version:

Congress did not intend to give such relief in the case of a will which was republished after October 9, 1969, because the decedent in that situation had an opportunity to become aware of the statutory changes and to change his will accordingly. When John A. Kerr executed a new will in 1970, republishing the terms of the 1969 will, there was an opportunity to redraft the will with due regard to the changes resulting from the Act. As is manifest, this opportunity was not taken, and since it was not, we see no way in which plaintiff can avoid the effect of the Act or curtail its applicability to this estate. Plaintiff has directed our attention to two cases which we suppose are cited to show that a court will not find a republication of a will when to do so would defeat the intention of the testator. Since John A. Kerr intended that there would be a deduction for the charitable interest remainders created by the trust, plaintiff asserts that a finding by this court of a republication would frustrate his intent. The 1970 will does not permit the desired deduction.

This is largely a rehash of plaintiff's misplaced arguments based on the doctrine of dependent relative revocation. Additionally, the two cases cited by plaintiff stand only for the proposition that later codicils to a will will not be held to overturn a will's provision when the codicil and will can be read together harmoniously.

In *Massachusetts Audubon Soc.* v. *Ormand Vill. Imp. Assn.*, (Sup. Ct. of Fla.) 10 So. 2d 494 (1942), the will devised certain real estate described as "Coacoochee Cottage." After the will was executed, another cottage was con-

"The committee also believes that it is appropriate to allow a reasonable period of time for existing wills and existing trusts to be modified to take the new rules into account. Accordingly, it is provided that the new rules are not to apply to property passing under a will in existence on October 9, 1969, or to property transferred in trust on or before October 9, 1969, if the individual dies within three years (i.e., before October 9, 1972) without having modified the will or the trust." S. Rep. No. 91-552, 91st Cong., 1st Sess.; 1969-3 C.B. 423, 482.

The Senate version was accepted in the final bill, cf. Conf. Rep. 91-782, 91st Cong., 1st Sess.; 1969-3 C.B. 644, 655. Plaintiff argues that the Senate report used the word "modify" rather than the word "republish" which appears in the Act and this change is significant. In the first place, we must use the word which the Act expresses. Even if we look to the word "modify" in the Senate report, plaintiff's contention that the 1969 will is not modified by the 1970 will is untenable; plaintiff offers no reason to read the word so restrictively, and its interpretation is not consistent with the purpose of the transition periods provided by the Act.

structed on the lot and there was a later codicil which had the effect of republishing the will. The codicil did not modify that part of the will covering the bequest of the cottage. The court held that there was no conflict between the codicil and the will and that the latter properly passed the new structure and the lot on which it was located to the named devisee.

In *Waterbury* v. *Munn* (Sup. Ct. of Fla.), 32 So. 2d 603 (1947) the will in issue established a valid spendthrift trust. A later codicil allowed the trustees (also the beneficiaries) to liquidate the trust property in their discretion. The court held that the codicil did not destroy the spendthrift trust provided for in the will and that the trust was not incompatible with the changes made by the codicil in enlarging the interests of the beneficiaries. The decision rests on the principle that a will and a codicil must be construed together and if the codicil can be given an operative effect consistent with the conditions of the will, the prohibitions of the will will be deemed to be unaffected by the codicil.

For the reasons stated above, we conclude that this estate is covered by section 2055(e) as amended by the Act, and that the deductions for the charitable interest remainders, other than the residences, were properly disallowed.

III.

A far more difficult question is raised by plaintiff's contention that section 2055(e) permits a deduction for the charitable remainder interests in the residences even though these interests were not left in one of the prescribed trusts.

The determination of the Internal Revenue Service that plaintiff was not entitled to a deduction for the charitable remainder interest in the residences was based upon the following Treasury Regulation on Estate Tax (1954 Code) (26 C.F.R.):

> §20.2055–2. *Transfers not exclusively for charitable purposes.*
>
> * * * * *

(e) *Limitation applicable to decedents dying after December 31, 1969*—* * *

(2) *Deductible interests.* A deductible interest for purposes of subparagraph (1) of this paragraph is a charitable interest in property where—

* * * * *

(ii) *Remainder interest in personal residence.* The charitable interest is a remainder interest, *not in trust,* in a personal residence. Thus, for example, if the decedent devises to charity a remainder interest in a personal residence and bequeaths to his surviving spouse a life estate in such property, the value of the remainder interest is deductible under section 2055. For purposes of this subdivision, the term "personal residence" means any property which was used by the decedent as his personal residence even though it was not used as his principal residence. For example, a decedent's vacation home may be a personal residence for purposes of this subdivision. The term "personal residence" also includes stock owned by the decedent as a tenant-stockholder in a cooperative housing corporation (as those terms are defined in section 216(b)(1) and (2)) if the dwelling which the decedent was entitled to occupy as such stockholder was used by him as his personal residence.

(iii) *Remainder interest in a farm.* The charitable interest is a remainder interest, not in trust, in a farm. * * * [Emphasis supplied.]

Plaintiff relies primarily on the opening clause in the first sentence of section 2055(e)(2) which is set out in full *supra:*

> (2) Where an interest in property (other than a remainder interest in a personal residence or farm or an undivided portion of the decedent's entire interest in property) passes or has passed from the decedent to a person, or for a use, described in subsection (a), * * *.

In contrasting this language with the language of the regulation, plaintiff argues that the addition of the words "not in trust" in the regulation is an invalid attempt by the Internal Revenue Service to exercise its authority to promulgate interpretive regulations.

Plaintiff also argues that the Act permits a deduction for a charitable remainder interest in a personal residence passing through an unapproved trust, because section

2055(e)(1) and (2) make reference to transfers to or "for a use." Assuming that Congress intended the word "use" as a term of art, plaintiff says that since the modern trust device evolved from the common law system of uses, the Act allows a deduction for remainder interests in personal residences in trust, and consequently, the Treasury Regulation is invalid because it excludes them. While this is an ingenious historical argument, there is nothing in the statute or its legislative history to confirm such an interpretation.

In urging that the regulation should be upheld, defendant maintains that it is not in conflict with the statute and that it reflects the intent of Congress that those remainder interests in a personal residence or farm, which pass free of trust, will qualify for the deduction. However, where such interests pass through a trust, it is the Government's position that the trust must conform to the requirements of section 2055(e) of the Internal Revenue Code of 1954 as amended by the Tax Reform Act of 1969.

Thus, the crux of the dispute between the parties is whether section 2055(e) allows a deduction only for an outright gift of a remainder interest in a residence or farm, *i.e.*, one not in trust, or permits, as well, a deduction for a remainder interest in a residence or farm that is in a trust but not in one of the trusts specifically sanctioned by the Act.

In order to resolve the issue, we begin with the well established principle that:

> * * * Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons. [*Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501 (1948).]

See also, Weyerhaeuser Co. v. *United States*, 184 Ct. Cl. 492, 497, 395 F.2d 1005, 1008 (1968) and *W & W Fertilizer Corp.* v. *United States*, 208 Ct. Cl. 443, 457, 527 F.2d 621, 628 (1975), *cert. denied* 425 U.S. 974 (1976). Since the statutory language leaves a doubt with respect to the application of the exception provided for a personal residence or a farm,

an examination of the legislative history, for whatever illumination it may shed, is necessary.

The House version of the Act did not contain any exception for personal residences or farms; this proviso was added by the Senate, for reasons clearly expressed in its report, S. Rep. No. 91–552, 91st Cong., 1st Sess.; 1969–3 C.B. 423, 479–80:

> The committee agrees with the House that a taxpayer should not be allowed to obtain a charitable contribution deduction for a gift of a remainder interest in trust to a charity which is substantially in excess of the amount the charity may ultimately receive. * * * Another provision of the [House] bill * * * denied a deduction for an outright gift of a remainder interest to charity except to the extent a deduction would have been allowed if the gift had been in trust. This had the effect of denying a charitable contributions deduction in the case of a *nontrust* gift of a remainder interest to charity.
>
> Although, as indicated above, the committee is in general agreement with the House regarding the need for a closer correlation between the charitable contributions deduction allowed for a gift of a remainder interest to charity and the benefit ultimately received by the charity, the committee believes that the House provision is unduly restrictive. The requirement that a deduction is to be allowed only if the remainder interest given to charity is in the form of an annuity trust or unitrust could have a significant adverse effect on established forms of charitable giving, such as pooled income fund arrangements, and *outright gifts of real property, such as a residence, where the donor reserves a life estate in the property.* Since these types of charitable giving cannot be framed in the form of an annuity trust or unitrust, the House provision would deny a deduction for the charitable gift. The committee believes that it is possible to continue to allow a charitable deduction in these types of cases with appropriate limitations, however, to prevent the overstating of the charitable contribution deduction. [Emphasis added.]

The final version of the Act adopted the Senate's suggestion regarding pooled income fund arrangements and gifts of real property, but the Conference Report[3] is

[3] In discussing acceptance of the Senate suggestion regarding a deduction for remainder interests, the Conference Report made only the following reference: "(2) In the case of a gift of a remainder interest in real property to charity it is provided that in determining the value of the gift straight line depreciation or cost depletion

unclear whether the amendment to the Act covered both charitable remainder interests in personal residences left in trust and as outright gifts.

Although there is nothing in the statute which expressly supports the rule announced in the regulation, we conclude that since the Senate version was adopted, the Senate Report provides the best available guide of the intent of Congress, and that the regulation is in accord with that intent. Under somewhat similar circumstances, we upheld a Treasury regulation in *Frank E. Mott* v. *United States*, 199 Ct. Cl. 127, 137, 462 F.2d 512, 517 (1972), *cert. denied* 409 U.S. 1108 (1973). As shown above, the Senate Report spoke only of pooled income arrangements, which is one of the trusts approved in the Act, and outright gifts of real property, such as a residence. No reference was made to a deduction for a remainder interest in a residence left in an unapproved trust. Therefore, we think that the regulation is valid and that a holding to the contrary would be an unreasonable interpretation of the statute, and contrary to the will of Congress.

As we have said, section 2055(e) was amended to eliminate possible abuses in the administration of trusts which might operate to deprive the charity of the future remainder interest for which the estate has been credited with a deduction. This concern is no less present with respect to personal residences which pass first through a trust not approved by the Act. Unlike an outright gift of a remainder interest in a residence where the charity is guaranteed the eventual deed upon the termination of the life estate, a remainder interest which passes through a trust and is subject to the trustee's exercise of discretionary powers, is not certain to be realized by the charity. The potential for abuse is dramatically evident in the trust established by the will of John A. Kerr:

* * * * *

> 1. I direct that my Trustee shall provide to my sister, HAZEL C. KERR, the use of my real estate in Sun City Center, Florida, and New Richmond, Quebec,

is to be taken into account." Conf. Rep. No. 91-782, 91st Cong., 1st Sess.; 1969-3 C.B. 644, 655.

> Canada, during her lifetime without charges of any nature and all expenses of maintaining said property shall be paid out of the net income of this Trust. *Either or both of said properties may be sold during my sister's lifetime only upon receipt of the written consent thereto of my said sister or her legal guardian.* [Emphasis added.]
>
> * * * * *

It is clear that the above-quoted language authorizes the trustee, upon the application or with the consent of the life beneficiary, to liquidate the two residences without the consent of any of the charities entitled to the remainder interest. Such action, if taken by the trustees, would deprive the charities of the certainty of receiving deeds to the properties; the proceeds from the sale could be mingled with the other trust assets and such assets could be administered in a manner which would deplete the value of the interest of the charities. The fact that none of these things was done in this case does not affect the result we have reached. It is the possibility for abuse which the Act sought to remove by limiting the kinds of trusts in which deductions may be taken for remainder interests bequeathed to charities.

CONCLUSION

For the reasons stated above, we hold that plaintiff is not entitled to the deductions claimed for the value of charitable remainder interests created in the will in suit and consequently, that plaintiff is not entitled to a refund of the taxes paid as a result of the disallowance of the deductions.

IT IS THEREFORE ORDERED, that the defendant's motion for summary judgment is granted as to all issues in suit, except that plaintiff is entitled, as defendant concedes, to an additional tax deduction for the costs incurred in this action, including reasonable attorney's fees. With that exception, plaintiff's motion for summary judgment is denied. Accordingly, the case is remanded to the trial division for a determination of such additional deductions

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and the amount of the tax refund to which plaintiff is entitled on account thereof.

On May 23, 1977 the trial judge filed a memorandum report that stated plaintiff had waived additional deductions and refund except as to any costs incurred hereafter in obtaining a reversal by the Supreme Court, and recommended that an order be entered to state that plaintiff is not entitled to refund of any federal estate tax and to dismiss plaintiff's petition with prejudice. On May 27, 1977 the court adopted the recommendation of the trial judge, and adjudged that plaintiff is not entitled to refund of any federal estate tax, and dismissed the petition with prejudice.

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550 F.2d 17

DAVID H. MILLER AND KENNETH W. MILLER v. THE UNITED STATES

[No. 59–71. Decided February 23, 1977]

ON THE PROOFS

Contracts; fraud against the United States; False Claims Act; penalties.—Plaintiff entered into a contract with the Department of Housing and Urban Development (HUD) for the repair and maintenance of approximately 1,200 mobile homes in the Hurricane Camille disaster area. The contract required plaintiff, *inter alia*, to make periodic inspections of the homes to check, clean and adjust all equipment, make needed repairs or replacements subject to a $50.00 cost limitation, and make service calls, also subject to a limit of $50.00—charges in excess thereof requiring prior approval of the Housing Manager or his assistant. During the period of contract performance, January 31, 1970 through June 10, 1971 (when the contract was terminated), plaintiff submitted a consolidated billing for each of the five months, all invoices for the month being included in the respective billing. No payments were made by the Government after the first month's billing because local HUD officials became suspicious of possible irregularities in plaintiff's operations. After a study local officials recommended that plaintiff be investigated for possible fraudulent billings and that the contract be terminated. Upon termination, an extensive special HUD audit was conducted which

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revealed that plaintiff negligently and irresponsibly presented, or caused to be presented, five false consolidated billings to the Government. Plaintiff, suing for breach of contract, claims that the Government improperly withheld money due under the contract, *i.e.* a sum represented by the difference between the unpaid billings and the one contract payment. On the basis of examination of the testimony at trial, the documents submitted by the parties, and the parties' briefs, it is *held* that the Government improperly withheld money due under the contract; that it has not been established that there was a blatant attempt by plaintiff to deceive, and accordingly the Government's counterclaim in fraud is denied and plaintiff's claim is not forfeited *per se;* that plaintiff violated the False Claims Act and is subject to its penalties; that for the overcharges and other false billings plaintiff must pay $2,000 for each of the five consolidated billings but not for each of the eleven false invoices used in calculating each billing; that of the three alternative methods of determining the amount due plaintiff for services rendered prior to termination, the best is the audit performed by the special team since it is based upon sound accounting principles and subject to verification through examination of the evidence submitted to the court. Plaintiff is entitled to recover $37,947.75 under the contract and defendant is entitled to recover $10,000 on its False Claims Act counterclaim, plaintiff's ultimate recovery being $27,947.75.

Fraud against the United States; Forfeiture of Fraudulent Claims Act; evidence of fraud.

[1] Fraud, resulting in forfeiture of a claim against the Government, can be found only on the basis of clear and convincing evidence. An intent to deceive the Government must be proved.

United States ⚖120

Fraud against the United States; False Claims Act; evidence of fraud.

[2] Negligent representation of a claim falls within the "knowledge" requirement of the False Claims Act. For instance, where plaintiff knew that the quantities of materials billed to the Government by his workmen were only estimates of materials actually used and he did not check his inventory or maintain any inventory control, this negligence resulting in substantial Government overbilling due to misrepresentation of the amount of materials actually used is within the purview of the Act. The fact that plaintiff relied on assistance from defendant's officials in preparing consolidated billings to defendant does not negate plaintiff's liability since he had the responsibility to make correct representations.

United States ⚖120

Fraud against the United States; False Claims Act; penalties.

[3] Under the False Claims Act a penalty is imposed for each false claim submitted to the Government for payment. Separate penalties should not be imposed based upon the number of false invoices used in calculating a final consolidated billing; rather, the consolidated billing constitutes the "claim." In the present case, to penalize for eleven

separate invoices plus the five consolidations of the same eleven invoices would be a miscarriage of justice; the Act never intended this form of double punishment.

United States ⚖122

A. D. Freeman, Jr., attorney of record for plaintiff. *Gerald L. Schrader* and *Alexander Younger*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before SKELTON, NICHOLS, and KUNZIG, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

This suit is based on a contract between plaintiff-Miller Brothers (Miller)[1] and defendant-United States Department of Housing and Urban Development (HUD) for the servicing of mobile homes in Plaquemines Parish,[2] Louisiana. Plaintiff claims that the Government improperly withheld money due under the contract. Defendant counterclaims, stating (1) that it overpaid on sums already remitted to plaintiff, (2) that Miller's claim is forfeit due to fraud,[3] and (3) that Miller, in the course of performing the contract, violated the False Claims Act.[4] The Government

[1] Throughout the opinion "Miller" is used to stand for the Miller brothers' partnership. This description not only recognizes that David Miller alone administered the contract, but also takes into account the basic partnership law principle that acts of one partner bind the partnership. H. Ballantine, Ballantine on Corporations, 7 (1946).

[2] A Parish is a jurisdictional and political subdivision in Louisiana, corresponding to counties in other states of the Union.

[3] 28 U.S.C. §2514 (1970), which provides:

A claim against the United States shall be forfeited to the United States by any person who corruptly practices or attempts to practice any fraud against the United States in the proof, statement, establishment, or allowance thereof.

In such cases the Court of Claims shall specifically find such fraud or attempt and render judgment of forfeiture.

[4] *United States* v. *Bornstein*, 423 U.S. 303, 305–07 n. 1 (1976), which states:

The False Claims Act was adopted in 1863. Act of Mar. 2, 1863, c. 67, 12 Stat. 696. It was re-enacted as Rev. Stat. §§3490–3494, 5438. The part of the Act dealing with civil prohibitions is now codified in 31 U.S.C. §231 *et seq.* The language used in Title 31 differs in some important respects from that contained in the Revised Statutes. Since Title 31 has not been enacted into positive law, the official text of the statute is that which appears in the Revised Statutes. See *United States* v. *Neifert-White Co.*, 390 U.S. 228, 228–229, n. 1; *United States ex rel. Marcus* v. *Hess*, 317 U.S. 537, 539–540, and n. 2.

The relevant statutory provisions are as follows:

§3490. "Any person not in the military or naval forces of the United States, or in the militia called into or actually employed in the service of the United States, who

further requests the statutory penalty of $2,000.00 for sixteen alleged violations of the Act.

After thorough examination of the testimony at trial, the documents submitted by the parties, and all briefs filed by counsel, we hold that Miller is entitled to recover in part. The amount is reduced, however, by the Government's False Claims Act counterclaim, which we find meritorious, again in part. As to the remaining two counterclaims, the Government appears to have abandoned its claim for overpayment, so we do not consider it. The fraud claim, we deny.

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shall do or commit any of the acts prohibited by any of the provisions of section fifty-four hundred and thirty-eight, Title 'CRIMES,' shall forfeit and pay to the United States the sum of two thousand dollars, and, in addition, double the amount of damages which the United States may have sustained by reason of the doing or committing such act, together with the costs of suit; and such forfeiture and damages shall be sued for in the same suit."

§5438. "Every person who makes or causes to be made, or presents or causes to be presented, for payment or approval, to or by any person or officer in the civil, military, or naval service of the United States, any claim upon or against the Government of the United States, or any department or officer thereof, knowing such claim to be false, fictitious, or fraudulent, or who, for the purpose of obtaining or aiding to obtain the payment or approval of such claim, makes, uses, or causes to be made or used, any false bill, receipt, voucher, roll, account, claim, certificate, affidavit, or deposition, knowing the same to contain any fraudulent or fictitious statement or entry, or who enters into any agreement, combination, or conspiracy to defraud the Government of the United States, or any department or officer thereof, by obtaining or aiding to obtain the payment or allowance of any false or fraudulent claim, or who, having charge, possession, custody, or control of any money or other public property used or to be used in the military or naval service, who, with intent to defraud the United States or willfully to conceal such money or other property, delivers or causes to be delivered, to any other person having authority to receive the same, any amount of such money or other property less than that for which he received a certificate or took a receipt, and every person authorized to make or deliver any certificate, voucher, receipt, or other paper certifying the receipt of arms, ammunition, provisions, clothing, or other property so used or to be used, who makes or delivers the same to any other person without a full knowledge of the truth of the facts stated therein, and with intent to defraud the United States, and every person who knowingly purchases or receives in pledge for any obligation or indebtedness from any soldier, officer, sailor, or other person called into or employed in the military or naval service any arms, equipments, ammunition, clothes, military stores, or other public property, such soldier, sailor, officer, or other person not having the lawful right to pledge or sell the same, every person so offending in any of the matters set forth in this section shall be imprisoned at hard labor for not less than one nor more than five years, or fined not less than one thousand nor more than five thousand dollars."

Section 5438 was repealed in 1909. Act of Mar. 4, 1909, c. 321, §341, 35 Stat. 1153. It has continued vitality only insofar as it specifies the acts giving rise to civil liability under §3490. *See United States* v. *Neifert-White Co., supra.* The criminal prohibitions were subsequently altered and codified in 18 U.S.C. §§287 and 1001.

In reaching our decision, we have determined that the Trial Judge's recommended findings of fact do not merit the normal presumption of correctness under Ct.Cl. Rule 147(b), and thereby substitute our own. We do this only with great difficulty upon being convinced by a thorough analysis of the complete record that the Trial Judge misconstrued the evidence submitted in this case. *See Ricci* v. *United States*, 205 Ct.Cl. 687, 697–98, 507 F.2d 1390, 1392 (1974); *Willett* v. *United States*, 186 Ct.Cl. 775, 787–88, 406 F.2d 1346, 1353 (1969); *Miller* v. *United States*, 168 Ct.Cl. 498, 501, 339 F.2d 661, 662 (1964).

Facts

The facts of this case are complicated and require thorough elaboration. We begin with the incredible devastation wrought on Plaquemines Parish, where Hurricane Camille struck this southeastern part of Louisiana on August 17, 1969. Virtually surrounded by water (three sides by the Gulf of Mexico and split lengthwise by the Mississippi River), the Parish was inundated. Wind, water and tornado combined to destroy virtually 100% of all homes. The communities of Venice, Boothville, Triumph and Pilottown were completely ruined. Buras and Empire were 80% and 60% lost.

As a result, the Parish was declared a major disaster area by the Federal Government on August 19, 1969.[5] As part of Government relief to the Parish, the Emergency Preparedness Administration made funds available to furnish housing for Hurricane Camille's victims—some 15,000 homeless evacuees. With these funds, HUD began a program to provide temporary housing in mobile homes, arranging with a private contractor to bring in and set up HUD-leased mobile dwellings throughout the Parish. In total, approximately 1,800 trailers were moved in to provide disaster relief housing.

From its inception until December 1969, when the last victims of the disaster were assigned trailers, the Emergency Relief Housing Program was administered by regular

[5] 34 Fed. Reg. 13770 (1969).

HUD employees from Houston and Fort Worth, Texas. After the regular HUD employees withdrew, the program was administered by Parish employees hired by HUD on a temporary basis. Kermit Ballay and Peter Turlich, both longtime Parish employees, were designated as Housing Manager and Assistant Housing Manager, charged with administering the housing program at the local level for HUD.

In December 1969, HUD issued an advertised competitive solicitation (VC-1–70) for repair and preventive maintenance on the approximately 1,800 mobile homes in the Hurricane Camille Disaster Area for the period December 23, 1969 or date of award (whichever was later) through August 18, 1970. The Miller brothers, as a partnership, were awarded the contract effective January 30, 1970.

The agreement contained provisions making the Service Contract Act, 41 U.S.C. §351 (1970), applicable. That Act requires the contractor to meet minimum wage standards and to maintain specified employment records. In addition, special provisions of the contract required Miller to use only new parts and materials or rebuilt parts with prior Government approval. Further, the contractor agreed to perform all work with competent mechanics, experienced and qualified to work on the specified equipment.

The contract provided that Miller would make periodic inspections of the mobile homes to check, clean and adjust all equipment including plumbing, heating, electrical systems and furniture furnished with the mobile homes. During such inspection, the contractor would also check the level of the trailer, re-level as required, and make any other needed repairs or replacements subject to a $50.00 cost limitation.

The contract also called for Miller to make service calls on the mobile homes at the direction of the Housing Manager. Service calls were to include, but were not limited to, repair or replacement of mechanical equipment, plumbing, electrical equipment, wiring and household fixtures, and appliances covered under the HUD mobile home lease. Also included in service calls were repairs to carpentry, sheet metal, painting, floor covering and roofing items. Each call was to be made within ten hours after

notification. Service call costs, including labor and materials, were limited to $50.00. Service calls exceeding $50.00 required the prior approval of the Housing Manager or his assistant.

The Housing Manager, Ballay, and his assistant, Turlich, were authorized by the contract to administer its provisions on behalf of the Contracting Officer, Leonard E. Church, HUD Deputy Regional Administrator in Fort Worth, Texas. The authorization did not, however, allow Ballay, the Housing Manager, to modify any contract terms or specifications.

Performance under the contract began on January 31, 1970. Miller assigned workmen to make the periodic inspections. Not one of these workmen was qualified to make repairs. At the outset, this situation was not a problem, even though the contract specified that certain repairs were to be made in conjunction with periodic inspections. Mr. Ballay, it appears, initially instructed Miller *not* to make repairs during inspection visits. It should be noted that Mr. Ballay was without authority to alter the contract in this regard. In March or April of 1970, Mr. Ballay changed his instructions to conform to the contract.

Service calls were made by David Miller or one of his workmen upon receipt of a complaint form from the HUD Housing Office in Buras. HUD trailer tenants phoned in complaints to that office, where a complaint form was prepared. Miller picked up the forms daily from the Housing Office and distributed them to his workmen for action. The workmen supposedly made the requested repairs and listed the work done, materials used, and time expended.

The complaint forms were then returned to Miller's trailer office where Sally Miller, David Miller's wife, prepared an invoice for HUD. Mrs. Miller supplied the cost of materials on the HUD invoice by looking up the cost of the material in a purchase book in which all purchases were supposedly recorded.

Miller made continuing purchases of contract materials at varying prices, but maintained no inventory program. Thus Mrs. Miller had no way of knowing, when she

prepared invoices for HUD, which of varying priced materials Miller's workmen had used on a particular service call. Consequently, on almost any invoice, it was possible for Mrs. Miller to charge defendant incorrectly.

For service calls costing in excess of $50.00 in labor and materials, the contract required Miller to secure the Housing Manager's, or his assistant's, approval before making the repairs. Approval was obtained by Miller telephoning the HUD Housing Office and receiving an "oral OK." Later Ballay and Turlich would review Miller's invoices, rejecting those over $50.00 for which neither HUD agent could remember granting approval. Over the course of the contract, 36 invoices were summarily rejected.

For the period of contract performance, January 31, 1970 through the June 10, 1970 termination date, Miller submitted five consolidated billings—one for each month of performance. In preparing each of the final billings, Miller submitted all invoices for the month to the HUD Housing Office in Buras. Mr. Ballay again looked over the invoices, and after discussion with David Miller, rejected still more invoices about which he had doubt. The remainder were totaled and submitted to HUD for payment.

The amounts submitted by Miller, approved by Ballay, and paid (or remaining unpaid) by the United States are as follows:

	Submitted by Miller	Approved by Ballay	Paid by U.S.
Jan. 31–Feb. 26, 1970	$9,156.82	$8,163.89	$8,163.89
Feb. 27–Mar. 31, 1970	20,193.36	13,555.16	—
Apr. 1–Apr. 29, 1970	8,101.36	8,041.18	—
Apr. 30–May 31, 1970	16,974.12	7,490.20	—
June 1–June 10, 1970	2,019.69	1,782.31	—
	$56,445.35	$39,032.74	
	−8,163.89	−8,163.89	$8,163.89
Unpaid	$48,281.46	$30,868.85	

No payments were made after the initial $8,163.89 because the local HUD officials became suspicious of possible irregularities in Miller's operation. The Assistant Housing Manager, Mr. Turlich, found several instances where work, listed as completed on invoices, had not been done. Mr. Turlich reported his findings on "materials billed but not furnished" to Mr. Ballay, who in turn relayed the information up the chain of command to the Contracting Officer (CO), Mr. Church.

Mr. Church ordered a study of the situation in Plaquemines Parish. Bruce Gipson, a HUD maintenance engineer (and a registered professional engineer in the State of Texas) was assigned to make the study. Mr. Gipson found that Miller did not keep payroll records or tallies of Social Security and Federal income tax withholdings as required by the Service Contract Act. In addition, while spot-checking invoices, Gipson discovered a number of instances where Miller had billed the Government not only for materials not furnished and work not done, but also billed for both a periodic inspection and a service call when only a periodic inspection billing was justified.

Mr. Gipson reported the results of his inquiry to the CO and recommended that Miller be investigated for possible fraudulent billings and that the contract be terminated. Based upon Gipson's report, the CO, by letter of May 28, 1970, notified Miller that the contract was terminated as of June 10, 1970. Miller does not dispute the termination.

Following termination of the contract, Miller was made the subject of a special HUD audit. Due to the chaotic (and sometimes non-existent) nature of Miller's records, this thorough audit took more than twice as long as the average HUD audit of this type—a total of 50 man-days. Upon conclusion of the audit, the HUD auditors determined (disallowing certain charges) that Miller had unpaid billings of $46,111.64. From this amount must be subtracted $8,163.89, already paid by defendant, leaving a final figure of $37,947.75 in unpaid billings.

Since the Government still withheld payment, Miller sued on February 26, 1971, for breach of contract in this court. Plaintiff alleged that he is due the difference

between the unpaid billings ($56,445.35 by his calculation) and the one contract payment ($8,163.89) or $48,281.46.[6]

Defendant counters, arguing that, due to fraudulent billing, Miller's claim is totally forfeit under 28 U.S.C. §2514 (1970). In addition, the Government seeks penalties from Miller for 16 alleged violations of the False Claims Act, *supra*, note 4.

We hold that Miller is entitled to recover in part,—$46,111.64 (the auditors' figure), less the contract payment of $8,163.89, minus $10,000.00 for five violations of the False Claims Act, or $27,947.75. We deny the Government's remaining counterclaim that Miller's suit be totally forfeit because of fraudulent billings.

Entitlement Under the Contract

Miller's right to recover is based on a breach of contract theory. The Government entered into an agreement with Miller. Miller was to provide services; the Government was to pay. The contract provides that, in the event of termination, the Government is *liable for services rendered to it "prior to the effective date of termination." Cf. Acme Process Equipment Co. v. United States*, 171 Ct.Cl. 324,359, 347 F.2d 509, 530 (1965), *rev'd on other grounds*, 385 U.S. 138 (1966). Therefore, absent compelling reason to the contrary, Miller should be entitled to recover at least to that extent.

Fraud Counterclaim

However, the Government contends that Miller's own actions furnish compelling reasons for denying his claim; that his conduct was fraudulent and his claim should be forfeited. Yet fraud, resulting in forfeiture, can be found only on the basis of clear and convincing evidence. *Chelsea Factors, Inc.* v. *United States*, 149 Ct.Cl. 202, 212, 181 F.Supp. 685, 691 (1960). An intent to deceive the Government must be proved. *Bar-Ray Products, Inc.* v. *United States*, 167 Ct.Cl. 839, 851 n. 14, 340 F.2d 343, 351 n. 14, (1964).

[6] *See supra*, page 66.

In the instant case, after careful analysis of the record, we find the evidence clear and convincing not of fraud, but of negligence and ineptitude. Plaintiff's failure to keep an inventory, his lack of payroll records (both discussed *supra*), and confused and incorrect invoices[7] resulting from slipshod supervision of the workmen[8] combine to form a pattern of carelessness and slothfulness. But, in analyzing the alleged fraud, we must add to Miller's difficulties, problems brought about by the Government: The local HUD official's orders not to perform any repairs during periodic inspections (contra to the contract), failure to maintain records of when this order was changed and HUD's slipshod method of approving expenses in excess of $50.00 "only when it was remembered."[9] Taken together, we think that the total effect of the activities surrounding the execution of this contract falls outside the scope of fraud.

It is a close question, and the line is hard to draw, but we come down on the side of ineptitude as against a blatant intent to deceive. The Government's counterclaim in fraud is thereby denied and plaintiff's claim is not forfeited *per se*.

False Claims Act Counterclaim

The Government contends that Miller owes the statutory penalty of $2,000.00 for each of eleven invoices used in calculating monthly consolidated billings *and* $2,000.00 for each of the five consolidated billings submitted by Miller for a total penalty of $32,000.00 (16 × $2,000.00). The

[7] These billings include such items as a faucet that plaintiff never installed but charged the Government for, a used sofa and chair installed when new material was required under the contract, and a used commode taken from a burned-out trailer, installed in a different trailer and billed to the Government as new.

[8] While David Miller testified that he "always checked" his men's work personally, in view of his other testimony—that he made frequent trips to New Orleans (a ride of several hours) and other surrounding towns to purchase materials and make repairs—it would appear that supervision was lax.

[9] Yet another problem was the Government's failure to preserve evidence to prove its case. Two HUD officials placed an X mark on a perfectly operating oven control valve, then placed a repair order. Later, after Miller submitted an invoice stating that the valve had been changed, only one of the men returned to check the work, finding the X-marked valve still in place. Yet no records, written (aside from the invoice) or pictorial, were kept of this potentially damaging incident.

Government bases its contention that Miller knew of the false claims upon testimony given by Miller that he "always checked" his men's work. As we stated above, *see supra* note 8, we do not think it possible that Miller could have so closely supervised the workmen.

The False Claims Act imposes a penalty on a person who:

> . . . presents . . . for payment . . . any claim upon or against the Government . . . *knowing* such claim to be false . . . . (*supra*, note 4). (emphasis supplied)

The Eighth Circuit has held that "negligent representation" of a claim falls within the "knowledge" requirement of the Act. *United States* v. *Cooperative Grain & Supply Co.*, 476 F.2d 47, 60 (8th Cir. 1973); Annot. 26 A.L.R. Fed. 307 (1976).

To use just one of many possible examples, Miller testified that he knew the quantities of materials billed by his workmen were only estimates of what had actually been used. But he did not bother to check his inventory; in fact, he failed to maintain any inventory control. As the auditors determined, the result of this extreme negligence was that the Government was substantially overbilled due to misrepresentation of the amount of materials actually used. Such conduct by Miller is within the scope of that proscribed in *Cooperative Grain, supra.*

In addition, Miller cannot escape liability by alleging that he relied on the local HUD official's assistance in preparation of the consolidated billings. Regardless of who actually summarized the individual tally of invoices for submission to the Government for payment, Miller, as the applicant, had the responsibility to make correct representations. *Cooperative Grain, supra,* 476 F.2d at 60. If this alone were not enough, Miller also signed each consolidated billing, evidencing his agreement to the figures it contained.

Upon a thorough examination of Miller's operations under the contract, as illustrated by the record, we hold that the Government is entitled to recover under its False Claims Act counterclaim. We must now decide the extent of that recovery.[10]

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[10] We note that the Government seeks only the $2,000.00 penalty, not double the

What is involved is a determination of the number of false claims submitted in this case. The Government argues for sixteen—eleven based on invoices used in calculating the monthly billings plus five, one for each of the monthly consolidated billings.[11] This position is refuted by both the Act and appropriate case law.

The Act imposes a penalty for each *false claim submitted to the Government for payment. See supra* note 4. In the instant case, plaintiff submitted only five such claims—the five consolidated billings. The invoices for which the Government also seeks the statutory penalty were used in determining the total of each claim. In this regard, the invoices are like tally sheets used in calculating a final figure to present to the Government; they are not the claim itself.

In finding five, not sixteen, false claims, we agree with the Ninth Circuit decision in *United States* v. *Woodbury*, 359 F.2d 370 (1966). In *Woodbury*, the court held that separate penalties are not imposed based upon the number of false papers contained in a particular claim made upon the Government. 359 F.2d at 378. The court reasoned that each amount requested from the Government is a claim, so regardless of the number of false invoices that were used in arriving at each demand, only one penalty per demand is imposed. *Id.*

This position is supported by the recent Supreme Court case, *United States* v. *Bornstein*, 423 U.S. 303 (1976)[12] (which the Government seems to be citing in support of its own position). In *Bornstein*, the Court held that 21 boxes of falsely marked items sent in three separately invoiced shipments, constituted only three violations of the False Claims Act. If the Supreme Court were to have followed defendant's current rationale and applied it to *Bornstein*, it

amount of the damages which is also allowed under the statute. *Supra*, note 4.

[11] Penalizing for eleven invoices *plus* the five consolidations of the same eleven invoices seems clearly a miscarriage of justice. The Act never intended this form of double punishment.

[12] We note that the Supreme Court cites *United States* v. *Woodbury*, 359 F.2d 370 (1966) (upon which we rely) with approval for the proposition that the number of false claims is determined by the number of demands the contractor has made upon the Government. *United States* v. *Bornstein*, 423 U.S. 303, 309 n. 4 (1976).

probably would have found 21 violations of the Act in *Bornstein*. The Court did not so hold.

In fact, the defendant's argument before this court seems more in line with Justice Rehnquist's dissent in *Bornstein* than with the majority opinion. It is the position of the dissent (and the Government in the instant case) that, based upon the facts of a particular case, each false item used in reaching a final figure which is then submitted for payment could be a violation of the Act. We reject this reasoning.

As the court holds only five false claims were submitted, we need not examine the alleged falsity of each of the eleven invoices upon which part of the Government's counterclaim is based. Rather we need only find that some part of each consolidated billing was false. This we find upon an examination of the auditors' report.

The audit showed that Miller billed the Government at prices exceeding costs for each of four chief materials used in performing the contract. The materials overbilled were stove control valves (billed at $18.12 instead of cost, $13.96, a total overcharge of $212.16), roof coating (billed at $5.23 per gallon instead of $4.95 per gallon, an overcharge of $99.68), sewer pipe (billed at $1.09 per linear foot instead of $.39, a total overcharge of $1,573.60), and window glass (a total overcharge of $502.91). These excessive charges continued over the life of the contract and were reflected in each consolidated billing. For these overcharges and other false billings, Miller must pay $2,000.00 for each of the five times he sought Government payment—a total of $10,000.00.

We hold that plaintiff has clearly violated the False Claims Act and is subject to its penalties.

Quantum

Up to this point, we have decided that Miller is entitled to recover under the contract, that his claim is not forfeit for fraud, and that he is liable for a $10,000.00 penalty under the False Claims Act. One issue remains, that of the amount due Miller under the contract for services rendered prior to termination. It is only upon calculation of this

amount, owed in accordance with the payment provisions of the contract, that the case can be finally concluded.

Although the Trial Judge appeared, in her opinion, to reserve the determination of quantum for later proceedings, we will consider the matter at this time. There was no stipulation by the parties to hold determination of amount until a later time. Ct.Cl. Rule 131. Further, an examination of the record reveals sufficient evidence upon which to compute the amount due plaintiff.

The evidence submitted at trial affords three possible ways of calculating the amount due Miller. The first is by using the consolidated billings submitted by Miller to the HUD authorities in Buras, Louisiana. (A total of $56,445.35 minus $8,163.89 already paid, or $48,281.46.)[13] This method is unacceptable. These figures were disputed not only by the local HUD managers, but also by the special HUD audit team that carefully examined Miller's books. In addition, giving Miller all that he requests would belie our decision that Miller substantially overbilled the Government.

The second possible manner of arriving at an amount due Miller is by taking the total of the consolidated billings prepared by Miller in conjunction with the local HUD authorities. The sum of the five consolidated billings, $39,032.74, reflects the examination and reduction by Ballay, the HUD Housing Manager, of Miller's original submission discussed above. Subtracting from this amount the $8,163.89 already paid to Miller by HUD leaves $30,868.85 owing.[14]

As with the figures originally submitted by Miller, this total is also unacceptable. While the local HUD officials made a good faith effort to scrutinize the invoices submitted by Miller, neither official is a trained accountant. Their methods are not available for review. From what information is available, it is obvious that the rejection of some invoices was done on an *ad hoc* basis from memory alone. We cannot base our determination on such procedures and also reject this method.

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[13] *See supra* at 66.

[14] *Id.*

The final ground upon which to rest assessment of quantum is the official HUD audit report. The audit was performed by a special team sent to Buras by the Regional HUD Office. The auditors, Allen Cash and William York, each spent approximately 25 man-days examining Miller's records. During this time, Miller had ample opportunity to urge his calculations on the auditors. Their report, based upon sound accounting principles and subject to verification through examination of the evidence submitted to the court, provides the best method of determining the amount properly due Miller under the contract. It is not clear that further proceedings or a lengthy new trial on quantum in the instant case would materially add to the facts already available.

This final total audit figure of $46,111.64 reflects analysis and examination by the auditors. It is lower than plaintiff's demand, yet higher than HUD's earlier *ad hoc* figure. Subtracting from this amount the $8,163.89 already paid to Miller leaves $37,947.75 owing. We hold that this is the final figure of unpaid billings.

However, because we have already decided that Miller must pay a $2,000.00 penalty for each of five false consolidated billings submitted to the Government, the $37,947.75 must be further reduced by $10,000.00 in order to arrive at the final sum owed Miller—$27,947.75.

In summary, upon examination of the briefs and after an exhaustive review of the evidence submitted in this case, we have determined that the Government did improperly withhold money under a contract with plaintiff for the servicing of mobile homes in Plaquemines Parish, Louisiana. We hold that Miller is entitled to recover $37,947.75 under the contract and that his claim is not forfeit due to fraud. The court also holds that defendant is entitled to recover $10,000.00 on its False Claims Act counterclaim. Plaintiff's ultimate recovery, therefore, is $27,947.75.

FINDINGS OF FACT

1. This is an action under 28 U.S.C. §1491 (1970) on unpaid claims for services rendered and material supplied under a contract between plaintiffs, doing business as

Miller Brothers Trucking, a partnership, and the Department of Housing and Urban Development (Solicitation, Offer, and Award, Standard Form 33, signed January 30, 1970), for the repair and preventive maintenance of 1800 mobile homes located in Plaquemines Parish, Buras, Louisiana. All work by plaintiffs under this contract was completed June 10, 1970.

2. Because payment was demanded by plaintiffs and refused by defendant, this action for breach of contract was filed February 26, 1971. Defendant counterclaimed for $32,000 under the False Claims Act, 31 U.S.C. §§231–35 (1970) and for return of an alleged overpayment plus interest on a payment made to plaintiffs; defendant also entered a special plea in fraud under 28 U.S.C. §2514 (1970) for forfeiture of plaintiffs' entire claim.

3. Hurricane Camille struck the Louisiana coast on August 17, 1969. This natural disaster devastated portions of Louisiana including and especially Plaquemines Parish (hereafter the Parish), a jurisdictional subdivision of the State of Louisiana, located in the southeast corner of the state below New Orleans, Louisiana. The Parish is comprised mainly of a low-lying peninsula extending out into the Gulf of Mexico and is completely surrounded by water. Due to the low-lying topography and its proximity to the Gulf of Mexico, the Parish is subject to the tremendous destructive forces of hurricanes. Testimony indicated that the Parish was like being in a plugged bathtub with water surrounding it. When Camille hit, water poured in with nowhere to drain.

4. The effect of Hurricane Camille on the Parish was that of complete devastation with virtually 100 percent of the Parish's residences, as well as its commercial or public buildings uninhabitable. After the storm, the Parish had over 15,000 homeless evacuees, temporarily housed in schools and public buildings which had escaped the storm's destruction. The Parish roads were blocked with debris, severely hampering restoration of services and reconstruction operations. It took several weeks merely to restore utility services.

5. The Parish was declared a major federal disaster area on August 19, 1970 under Presidential authority. 34 Fed.

Reg. 13770 (1969). As part of Government relief to the Parish, the Emergency Preparedness Administration made funds available to furnish housing for Hurricane Camille's victims. With these funds, the Department of Housing and Urban Development (hereafter HUD) began a program to provide temporary housing in mobile homes. HUD arranged with a private contractor to bring in and set up HUD-leased mobile homes throughout the Parish. Some of these mobile homes were set up in trailer parks established throughout the Parish and others were set up on private land owned by the tenant. In total, approximately 1800 trailers were moved into the Parish to provide disaster relief housing. These were allocated to hurricane victims according to a HUD policy with trailer occupancy priority following four classes in descending order: persons providing necessary and essential community services; persons engaged in providing medical services; handicapped persons and the elderly.

6. From its inception until December 1969, when the last of the disaster victims were assigned trailers, the Emergency Relief Housing Program was administered by regular HUD employees from Houston and Fort Worth, Texas. By dint of the requirements of the Parish, when the regular HUD employees withdrew from the Parish, the program was administered by Parish employees hired by HUD on a temporary basis. Kermit Ballay and Peter Turlich, both longtime Parish employees, were designated as Housing Manager and Assistant Housing Manager, respectively, and charged with the task of administering the contract at the local level for HUD.

7. Following the hurricane, plaintiff David H. Miller (hereafter plaintiff) had been hired by a private contractor along with his own truck to set up trailers acquired by HUD for its disaster relief housing program in the Parish. During this time, plaintiff became acquainted with the officials supervising the program, the geography of the Parish, and the mechanical operation of these trailers. Plaintiff also became well acquainted with Mr. Turlich, who often accompanied him to direct him to the locations in the Parish where trailers were to be placed.

Findings of Fact

8. In December 1969, HUD issued an advertised competitive solicitation (VC-1–70) for repair and preventive maintenance on the approximately 1800 mobile homes in the Hurricane Camille Disaster Area of Plaquemines Parish, Louisiana for the period December 23, 1969 or date of award (whichever is later) through August 18, 1970. Plaintiffs (David Miller and his brother, Kenneth Miller, as a partnership) were awarded the contract effective January 30, 1970.

9. The contract between the parties identified Mr. Ballay as the Housing Manager, while Mr. Leonard E. Church, Deputy Regional Administrator, HUD Region V, Fort Worth, Texas, was identified as Contracting Officer. (DX 2). Mr. Peter Turlich, a Plaquemines Parish resident, was hired as Mr. Ballay's assistant.

10. The contract (DX 2) contained the following pertinent provisions:

SERVICE CONTRACT ACT OF 1965

* * * * *

THE FOLLOWING PROVISIONS APPLY TO ANY CONTRACT AWARDED UNDER THIS SOLICITATION WHICH IS IN EXCESS OF $2500:

(a) Service Contract Act of 1965: This contract, to the extent that it is one of the character to which the Service Act of 1965 (79 Stat. 1034, 41 U.S.C. 351) applies, is subject to the following provisions and to all other applicable provisions of the Act and the regulations of the Secretary of Labor thereunder (29 CFR Part 4).

(b) Each service employee employed in the performance of this contract by the contractor or any subcontractor shall be paid not less than the minimum monetary wage and shall be furnished benefits in accordance with the wages and fringe benefits determined by the Secretary of Labor or his authorized representative, as specified in any attachment to this contract. * * * Failure to pay such employees the compensation agreed upon by the interested parties or finally determined by the Administrator [of the Wage and Hour and Public Contracts Division of the Department of Labor] or his authorized representative shall be a violation of this contract. No employee engaged in performing work under this contract shall in any event be paid less than

the minimum wage specified under section 6 (a)(1) of the Fair Labor Standards Act of 1938, as amended ($1.60 per hour).

* * * * *

(d) In the absence of a minimum wage attachment for this contract, neither the contractor nor any subcontractor under this contract shall pay any of his employees performing work under the contract (regardless of whether they are service employees) less than the minimum wage specified by section 6(a)(1) of the Fair Labor Standards Act of 1938 ($1.60 per hour). However, in cases where section 6(e)(2) of the Fair Labor Standards Act of 1938 is applicable, the rates specified therein will apply. Nothing in this provision shall relieve the contractor or any subcontractor of any other obligation under law or contract for the payment of a higher wage to any employee.

* * * * *

(g) The contractor and each subcontractor performing work subject to the Act shall make and maintain for 3 years from the completion of the work records containing the information specified below for each employee subject to the Act and shall make them available for inspection and transcription by authorized representatives of the Administrator of the Wage and Hour and Public Contracts Divisions of the U.S. Department of Labor.

(1) His name and address.

(2) His work classification or classifications, rate or rates or monetary wages and fringe benefits provided, rate or rates of fringe benefit payments, in lieu thereof, and total daily and weekly compensation.

(3) His daily and weekly hours so worked.

(4) Any deductions, rebates, or refunds from his total daily or weekly compensation.

(5) A list of monetary wages and fringe benefits for those classes of service employees not included in the minimum wage attachment to this contract, but for which such wage rates or fringe benefits have been determined by the interested parties or by the administrator or his authorized representative pursuant to the labor standards clause in paragraph (b) of this section. A copy of the report required by the clause in paragraph (k) of this section shall be deemed to be such a list.

(h) The contracting officer shall withhold or cause to be withheld from the Government Prime Contractor

under this or any other Government contract with the prime contractor such sums as he, or an appropriate officer of the Labor Department decides may be necessary to pay underpaid employees. Additionally, any failure to comply with the requirements of these clauses relating to the Service Contract Act of 1964 may be grounds for termination of the right to proceed with the contract work. In such event, the Government may enter into other contracts or arrangements for completion of the work, charging the contractor default with any additional cost.

(i) The contractor agrees to insert these clauses relating to the Service Contract Act of 1965 in all subcontracts. The term "contractor" as used in these clauses in any subcontract, shall be deemed to refer to the subcontractor, except in the term "Government Prime Contractor."

(j) As usexd (sic) in these clauses relating to the Service Contract Act of 1965, the term "service employee" means guards, watchmen, and any person engaged in a recognized trade or craft, or other skilled mechanical craft, or in unskilled, semiskilled, or skilled manual labor occupations; . . . .

* * * * *

INCORPORATION OF FORMS

The following forms are hereby incorporated by reference and made a part of this Invitation for Bids, receipt of which is hereby acknowledged by the bidder. Copies of these forms, if not enclosed, are available upon request from the issuing office shown on page 1 of this Invitation for Bids or from any General Services Administration Business Service Center.

GSA Form 1714; Equal Opportunity Clause, February 1969 edition. (This replaces Clause 18 of Standard Form 32).

* * * * *

SPECIAL PROVISIONS

* * * * *

2. *SERVICES AND MATERIALS TO BE SUPPLIED:*

a. Materials and Supplies:

* * * * *

(2) All material or parts supplied by the contractor and used in the repair of equipment shall be new and conform to the original equipment manufacturer's specifications unless otherwise approved by the Government. Rebuilt assemblies may be used in the repair of equipment with prior approval of the Government, when such is standard industry practice, and the rebuilt assembly carries the same warranty as new assembly.

b. *Competent Mechanics and Modern Equipment to be Employed:* The Contractor agrees that all work will be performed by competent mechanics, experienced and qualified to work on the specified equipment, and that all work will be performed in accordance with the best commercial practices and without unnecessary delays. Contractor must have available suitable modern equipment and tools necessary for the satisfactory repair, preventive maintenance, cleaning, lubrication, and transportation of subject equipment.

c. The contractor shall perform periodic inspection at intervals of 90 days, of each occupied mobile home, as directed by the Housing Manager. During this inspection all equipment, including plumbing, heating, electrical system and furniture, furnished under the Mobile Home Lease, shall be inspected, cleaned, and adjusted, including cleaning or replacement of heating unit filters, and replacement of faucet bibs and commode ball cock washers. Trailers shall be checked for level and releveled as required. Any other needed repairs or replacements shall be made during the inspections; subject to the cost limitation of $50.00.

d. Service calls shall be performed as directed by the Housing Manager, Housing and Urban Development, Hurricane Camille Disaster Relief Area Office, Plaquemines Parish, Buras, Louisiana. Service calls shall include, but are not limited to, repair and/or replacement of mechanical equipment, plumbing, electrical equipment, wiring, and household fixtures and appliances covered under the Mobile Homes Lease. Also included is carpentry, sheet metal, painting, floor covering and roofing repair items. Each service call will be made within 10 hours after notification is given.

Repairs and parts replacements costing in excess of $50.00 including labor and materials must have prior approval of the Housing Manager.

e. Billing for Services Rendered: An invoice shall be prepared for each periodic inspection made and for each service call, showing hours and costs of labor, itemization and cost of parts and cost of other supplies incidental to

repairs. Each invoice shall show location by unit number and name of occupant, if occupied. Originals of invoices shall be submitted together with a consolidated billing to the ordering office on the last day of each month. The consolidated billing shall be in original only with each invoice listed as a separate line by number, date and amount. Contractors will be required to present with their invoice adequate proof of the actual cost of parts, paint and other materials used in the performance of this contract. A copy of the suppliers' invoice which lists all discounts allowed the contractor, will normally be required.

* * * * *

6. *CONTRACT ADMINISTRATION:* Housing Manager, Housing and Urban Development, Hurricane Camille Disaster Area Relief Office, Plaquemines Parish, Buras, Louisiana, shall act for and on behalf of the Contracting Officer in the administration of this contract with respect to: (1) expediting; (2) resolution of issues that may arise between contractors and ordering agencies in connection with such matters as priority orders, timely deliveries, acceptability of workmanship, and other technical requirements; and (3) evaluation on an overall basis of the acceptability of workmanship and contractor compliance with technical requirements of the contract. This delegation does not authorize the modification of any of the contract terms or specifications. All authorities not herein delegated are reserved to the Contracting Officer.

* * * * *

8. *TERMINATION:* The Contracting Officer, may terminate this contract in whole or in part by giving the contractor five (5) days written notice when it is in the best interest of the Government. In the event the contract is terminated, the Government shall be liable only for payment in accordance with the payment provisions of this contract for services rendered prior to the effective date of termination.

* * * * *

BID SCHEDULE

ITEM NO.	UNIT	BID PRICE
1. LABOR:		
a. Periodic Inspection (Includes Labor, Travel Time, Mileage Parts and		

Materials as defined in 2(c))	Each	$3.65
b. Service Call (as defined in 2(d) (1 hour minimum including labor, travel time and mileage)	Each	$10.65
c. Service Call in excess of 1 hour	Man Hour	$5.90

2. *PARTS AND MATERIALS*

All Parts and Materials supplied by the Contractor, other than materials furnished as a part of the periodic inspection, shall be billed at Contractor's actual cost, plus 15%.

11. Mr. Ballay, as Housing Manager, properly advised plaintiffs of their obligations to carry Workmen's Compensation Insurance, to comply with the Equal Opportunity Clause of the contract, and to have their electrician licensed by Plaquemines Parish. Plaintiffs, however, viewed these admonitions as harassment on the part of Mr. Ballay. Plaintiffs' views are without foundation in fact, as are their other allegations of harassment by Mr. Ballay.

12. Kenneth Miller made only one trip to the Parish from his home in Johnson City, Tennessee, for the purpose of joining plaintiff, his brother, David Miller, who was already in the Parish to sign plaintiff's contract. He arrived in the Parish on Wednesday, January 28, 1970. However, actual execution of the contract was delayed by defendant's Housing Manager until late on January 30, 1970. Kenneth Miller took no active part in the performance of plaintiff's contract and returned to Tennessee after signing the contract.

13. Periodic inspections were largely performed by Mr. Jack Thompson and, after he left plaintiffs' employ, by Mr. Larry Foulk. After inspecting a mobile home, they filled out a periodic inspection report listing anything which needed to be repaired. The inspection reports were then turned over to Mr. Ballay in the local HUD office at the end of the day. In the morning, they would be delivered to

plaintiffs to make the necessary repairs. Messrs. Thompson and Foulk did not themselves repair any of the problems which they discovered in the course of periodic inspections. They were not qualified to make such repairs.

14. Apparently, plaintiffs were at first directed by Mr. Ballay not to perform repairs in conjunction with a private inspection. Later, however, sometime in March or April 1970, plaintiffs were instructed by Mr. Ballay to perform needed repairs in the course of making a periodic inspection. At no time did the Contracting Officer authorize Mr. Ballay to modify the contracting provisions regarding the billing of periodic inspections and service calls.

15. When occupants of mobile homes leased by HUD had problems with those mobile homes, they phoned in their complaints to the local HUD office which recorded the information on complaint forms. The complaint forms would then be turned over to Mr. David Miller who assigned them to the appropriate workman or workmen who handled the particular problem(s) noted on the complaint form. After making the necessary repairs, the workmen would record, on the complaint form in half hours, the amount of time they had worked making the repair as well as the materials used in making the repair. A number of the materials used, *e.g.*, roof coating, glass, and sewer pipe, were such that the quantities used on a particular repair job could be estimated only. Plaintiff David Miller had previous experience with one of those materials, roof coating, and was aware that the quantities recorded by his workmen were estimates only. Mr. David Miller checked a considerable amount of the work of his employees and performed some of the work himself, notably some of the plumbing and all of the stove or furnace problems after mid-March 1970.

16. After the workmen had examined what had to be repaired, if it appeared that the repairs on a single mobile home would cost in excess of $50.00 in materials and labor, plaintiffs' workmen were supposed to request and receive the approval of the Housing Manager, Mr. Ballay, or his duly authorized delegate, Mr. Turlich, before proceeding with the repairs. That could be accomplished by phoning

the local HUD office from the telephone located in the mobile home which was to be repaired.

17. Plaintiffs' books and records were kept by Mrs. Sally Miller, the wife of plaintiff David Miller. When plaintiffs' workmen turned in the complaint form or work order on a completed repair job, Mrs. Miller would make out the service invoice or billing using, in part, the information recorded by the workmen on the complaint form or work order. In filling out the service invoice, Mrs. Miller priced the materials used according to the prices on billings received from the manufacturers from whom plaintiffs purchased their supplies. For each material, she would use the price of one supplier until plaintiffs changed to another supplier.

18. The cost of materials used on the contract fluctuated quite a bit during the contract period. Plaintiffs also used different brands and different suppliers with different prices for the same material.

19. When invoicing the Government for material used, Mrs. Miller had no way of knowing which brand of a material a workman had taken with him and used on a repair job. Nor, since plaintiffs maintained no inventory control, did she have any idea of inventory on hand—*i.e.*, of how much of each particular material plaintiffs had on hand. As a consequence, she did not know when the supply of a material purchased at one price had been exhausted so that the workmen would be using the supply of the same material which was purchased at a different price.

20. Plaintiffs billed the Government for a total of 74 stove control valves. In fact, however, plaintiffs purchased 87 stove control valves and had a closing inventory of 36 valves, leaving a net of 51 stove control valves which could have been furnished under the contract. Therefore, plaintiffs overbilled the Government for 23 valves. Plaintiffs billed the Government an average of $18.12 for stove control valves. The total amount of overbilling involved for stove control valves per se, therefore, was $416.76. In addition, however, plaintiffs charged an overhead and profit rate of 15% of cost, for a total of $62.51, plus 1 hour labor per stove control valve at a rate of $5.90 per hour, for

a total of $135.70. Therefore, the aggregate overbilling for the 23 stove control valves amounted to $614.97.

21. With respect to the 51 stove control valves which plaintiffs presumably replaced, 12 were returned to Brown Stove Works, Cleveland, Tennessee, the manufacturer, which gave plaintiff a credit memorandum dated April 25, 1970 in the amount of $145.20 to be applied against future purchases. No such credit was passed on to HUD, as required by the contract.

22. Plaintiffs billed the Government for a total of 547 gallons of roof coating. In fact, however, plaintiffs purchased 381 gallons of roof coating and had a closing inventory of 25 gallons, leaving a net of 356 gallons which could have been furnished under the contract. Plaintiffs, therefore, overbilled the Government for 191 gallons of roof coating. Plaintiffs billed the Government an average of $5.23 for a gallon of roof coating or a total of $998.93 for the 191 gallons billed, but not purchased. In addition, however, plaintiffs charged an overhead and profit rate of 15% of cost, for a total of $149.84, plus 210 hours of labor, at $5.90 per hour, for a total of $1,239.00. Therefore, the aggregate overbilling for the 191 gallons of roof coating amounted to $2,387.77.

23. With respect to each of the 4 main materials used in performing the contract, plaintiffs billed the Government at prices which exceeded their costs:

A. *Stove Control Valves:* Plaintiffs billed the Government an average of $18.12 for stove control valves whereas their average cost in purchasing stove control valves was only $13.96—a difference of $4.16 per valve for a total overbilling of $212.16 for the 51 valves furnished by plaintiffs.

B. *Roof Coating:* Plaintiffs billed the Government an average of $5.23 a gallon for roof coating whereas their average cost for purchasing roof coating was only $4.95 per gallon—a difference of $0.28 per gallon for a total overbilling of $99.68 for the 356 gallons furnished by plaintiff.

C. *Sewer Pipe:* Plaintiffs billed the Government an average of $1.09 a linear foot for the 2,248 feet of sewer pipe which they claimed to have furnished, whereas, in

fact, their average cost per linear foot on the 2,920 feet of sewer pipe purchased was only $0.39—a difference of $0.70 per linear foot for a total overbilling of $1,573.60 for the 2,248 linear feet billed.

D. *Window Glass:* Plaintiffs billed the Government a total of $1,656.65 for window glass whereas they purchased a total of $1,153.74 worth of glass—for a total overbilling of $502.91.

24. The invoices for service calls, when completed by Mrs. Miller, were turned in to Mr. Ballay at the local HUD office.

25. Much the same procedure was used with respect to the invoices for periodic inspections—Mrs. Miller prepared the invoices based on the inspection reports turned in by the inspectors and the invoices, when completed by Mrs. Miller, were turned in to Mr. Ballay at the local HUD office.

26. When plaintiffs' service invoices were submitted to the local HUD office, the Housing Manager and his assistant, Messrs. Ballay and Turlich, respectively, went over the invoices and initialed those invoices in excess of $50.00 for which either of them could remember having granted prior telephone approval. No written records were kept; initialling took place up to a month after oral approvals were given. Over the course of the entire contract period, they discovered a total of 36 service invoices in excess of $50.00 for which plaintiffs had not requested and obtained prior approval before making the repairs.

27. The Housing Manager and his assistant also found a number of invoices in which plaintiffs had performed and billed the Government for repair work in addition to or other than what the complaint form directed them to repair.

28. The Assistant Housing Manager, Mr. Turlich, determined that on a number of invoices, plaintiffs billed the Government too many hours for the amount of work done. Mr. Turlich's basis for that determination was the amount of time such repairs had taken other contractors who had maintained and serviced the HUD-leased mobile homes in

the Hurricane Camille Disaster Area before plaintiffs were awarded their contract.

29. Mr. Turlich's main area of responsibility was to work in the field checking the repair work done by plaintiffs. As soon as plaintiffs submitted invoices for service calls, Mr. Turlich would take those invoices and, concentrating on those in excess of $50.00, start checking the actual repair work done on the service calls for which the invoices were submitted.

30. In the course of checking the repair work for which plaintiffs had billed the Government, Mr. Turlich discovered a number of instances in which plaintiffs had billed the Government for work which had not been done and material which had not been furnished:

A. Plaintiffs submitted an invoice dated March 3, 1970 for HUD Trailer No. 689 on which the Government was billed for a burner control valve, an oven control valve, and an oven control knob. When Mr. Turlich went to the trailer to check the work, he found that the materials had not been furnished and the work had not been done.

B. Plaintiffs submitted an invoice dated March 6, 1970 for a service call to HUD Trailer No. 1360, occupied by Miro Slavich, on which the Government was billed for a sheet of celotex. When Mr. Turlich checked the work done on the trailer, he found that the sheet of celotex had never been furnished.

C. Plaintiffs submitted an invoice dated March 7, 1970 for a service call to HUD Trailer No. 996, occupied by a Mr. and Mrs. Henderson, on which the Government was billed for 3 door glasses. When Mr. Turlich checked the trailer, he found that only 1 door glass could have been furnished since the door on that trailer contained only 1 glass.

D. Plaintiffs submitted an invoice dated May 8, 1970 for a service call to HUD Trailer No. 265, occupied by a Mr. and Mrs. Lawrence Bansy, on which the Government was billed for a heating element and 2 window screens. When Mr. Turlich checked the trailer, he found that the heating element and window screens had not been installed.

31. Mr. Turlich reported his findings on materials billed for, but not furnished, to Mr. Ballay who, in turn, relayed the information to Mr. Roy Kraft, their supervisor. Mr. Kraft was an occupancy specialist on the staff of Mr. Thomas Callahan, the Assistant Regional Administrator for Housing Assistance who, in turn, was the subordinate of the Contracting Officer, Mr. Leonard Church, the Deputy Regional Administrator for Housing Assistance.

32. The information relayed to Mr. Kraft evidently made its way up the chain of command to the Contracting Officer, Mr. Church, for he instructed Mr. Callahan to have a study made of the circumstances in Plaquemines Parish. Mr. Bruce Gipson, a maintenance engineer employed by HUD and a Registered Professional Engineer of the State of Texas, was assigned to make the study. Before going to Plaquemines Parish, Mr. Gipson discussed with Mr. Kraft the contract and the problems which had developed.

33. Mr. Gipson arrived in the Parish late on the afternoon of April 13, 1970 and spent the following three days there. Since he was only able to make a spot check of plaintiffs' billings in the time available, he chose 67 billings from the month of March 1970 as a representative sample. His purpose was to see whether there was some evidence of fraudulent billing or incompetent work.

34. Mr. Gipson first attempted to verify plaintiffs' billings for labor by comparing them to the plaintiffs' payroll records. He was unable to make that comparison, however, because plaintiffs did not have any payroll records—all they had was a small, ruled notebook with a list of names and some figures after them which he was told was the weekly salaries. Plaintiffs had no record of any Social Security and federal income tax withholdings from their employees' salaries.

35. Mr. Gipson attempted to verify plaintiffs' billings for materials used by checking the invoices to see what material was supposed to have been used and then checking the particular trailer to see whether the material had actually been used. He discovered a number of instances in which plaintiffs had billed the Government for materials not furnished or work not done:

A. Plaintiffs billed the Government for 1 tube of caulking material for HUD Trailer No. 1556 and for 3 tubes of caulking material for HUD Trailer No. 1149. When Mr. Gipson inspected the trailers, however, he discovered that the windows had not been caulked.

B. Plaintiffs submitted an invoice dated March 17, 1970 for HUD Trailer No. 1096 on which the Government was billed for the replacement of an oven control. When Mr. Gipson inspected the trailer, however, he discovered that no new oven control had been installed.

C. Plaintiffs submitted an invoice dated March 26, 1970 for HUD Trailer No. 189, occupied by one Willie Tony, in which they billed the Government for a new commode. Mr. Gipson inspected this work in response to a complaint by the tenant that one of plaintiffs' workmen had, in the course of cleaning up the trailer at an earlier date, broken the previous commode, which was subsequently replaced with a *green* commode in the tenant's *beige-colored* bathroom. Mr. Gipson's inspection disclosed that the handle on the supposedly new commode had been damaged by fire. He also found a burned-out trailer which contained a *beige* commode in a *green* bathroom, the base of which *beige* commode was broken. A reasonable inference is that the green commode installed by plaintiffs was not a new commode purchased by plaintiffs, but a used commode which had been taken from the burned-out trailer leased by HUD.

36. Mr. Gipson also discovered that plaintiffs billed the Government for both a periodic inspection and a service call when, during a periodic inspection, their workers performed necessary repairs on a mobile home. He found other instances where plaintiffs billed the Government a service call for repair work which was not, but should have been, done at the same time as the periodic inspection.

37. Due to their suspicions of the truthfulness of plaintiffs' billings, Messrs. Gipson and Turlich placed an X mark on a trailer oven control in perfect operating order. They then filled out a tenant's complaint form regarding the oven control and placed the form in the complaint box for plaintiffs to pick up. Mr. Gipson then had to return to

his home office in Texas. Shortly thereafter, plaintiffs submitted an invoice representing that they had changed the oven control. When Mr. Turlich returned to the trailer, he found the X-marked oven control still in place—contrary to plaintiffs' representation, it had not been replaced with a new oven control valve. Mr. Turlich, however, took no steps to preserve this evidence.

38. Within a few weeks after Mr. Gipson's return to Texas, plaintiffs submitted an invoice dated April 29, 1970 for a service call on HUD Trailer No. 1096 on which they represented that they had replaced the oven control. This was the same trailer on which plaintiffs had charged the Government for installing a new oven control only 43 days earlier. Unless they are defective, oven control valves should last several years. They are customarily guaranteed by the manufacturer for a minimum of 90 days and are replaced by the manufacturer if they fail sooner. Plaintiffs did, in fact, return 12 defective oven control valves to the manufacturers and received 12 new oven control valves to replace them. Plaintiffs, nonetheless, charged the Government for a new oven control which was allegedly installed in HUD Trailer No. 1096 on or about April 29, 1970.

39. Mr. Gipson reported the results of his inquiry to his immediate supervisor, Mr. Joseph Kemble. Copies of his report were also sent to Mr. Roy Kraft and to the Contracting Officer, Mr. Leonard Church. In his report, Mr. Gipson recommended: (1) that the Labor Relations Officer investigate plaintiffs for possible violation of the Davis-Bacon Act by reason of their failure to keep the required payroll records, (2) that the HUD Special Investigator send someone to look into the fraudulent billings submitted by plaintiffs, and (3) that the contract be terminated.

40. Based upon the contents of Mr. Gipson's report and conversations with persons who had made earlier trips to Plaquemines Parish, the Contracting Officer, Mr. Church, decided it was in the best interests of the Government to terminate plaintiffs' contract. By letter of May 28, 1970, plaintiffs were notified that their contract was terminated effective June 10, 1970 pursuant to Paragraph 8 of the contract. The date of June 10, 1970 was selected to allow

sufficient time for delivery of the termination letter by mail and still afford plaintiffs the five days' notice required by the contract. Plaintiffs have offered no evidence to show that Mr. Church's decision was made in bad faith.

41. At the end of each month during the life of the contract, a consolidated billing, listing invoices for service calls and periodic inspections, was prepared by the local HUD office. A total of 5 such consolidated billings was prepared by the local HUD office and signed by Mr. David Miller on behalf of the plaintiffs with the knowledge that they were to be presented to the Government for payment.

42. The consolidated billings, as prepared by the local HUD office, did not include all the invoices for service calls and periodic inspections submitted by plaintiffs. Those invoices which were not approved by Messrs. Ballay and Turlich for one reason or another were set aside and were not included in the consolidated billings. Mr. Ballay stored the unapproved invoices in a separate file drawer.

43. For the period of contract performance, January 31, 1970 through February 26, 1970, plaintiffs submitted invoices totalling $9,156.82. The local HUD Housing office in Buras, Louisiana, under the direction of Mr. Ballay, assisted in preparation of the consolidated billing for submission to HUD's Regional Office for payment. In preparing these consolidated billings, Mr. Ballay rejected with notification and explanation to plaintiffs some of plaintiffs' invoices for the above period and submitted his own consolidated billing for payment in the amount of $8,163.89. Mr. David Miller signed the billing to evidence his agreement. Plaintiffs received a Treasury Department check dated March 19, 1970 in the amount of $8,163.89.

44. For the period February 27, 1970 through March 31, 1970, plaintiffs submitted invoices totalling $20,193.36 ($2,982.05 for periodic inspections; $17,211.31 for service calls). Again Mr. Ballay prepared a memorandum of acceptance dated April 13, 1970 for $13,555.16 of the invoiced amount. Plaintiffs, however, received no payment for labor or materials invoiced for the above time period, although the contract required monthly payments.

45. Between April 1, 1970 and April 29, 1970, plaintiffs submitted invoices in the amount of $8,101.36. The

memorandum of acceptance and consolidated billing prepared by the local HUD officials, pared plaintiffs' billings for this period to $8,041.18. Again, no payment for plaintiffs' invoices submitted between April 1, 1970 and April 29, 1970 was made by defendant.

46. Plaintiffs submitted invoices for the period April 30, 1970 through May 31, 1970 in the total amount of $16,974.12 ($813.95 for periodic inspections; $16,160.17 for service calls). In preparing the consolidated billing and memorandum of acceptance for this period, Mr. Ballay approved payment of only $7,490.20. Defendant made no payment on any of plaintiffs' invoices for this period.

47. Plaintiffs continued contract performance through the June 10, 1970 termination date and submitted invoices for labor and materials supplied under the contract for the period June 1, 1970 through June 10, 1970 in the amount of $2,019.69. On July 21, 1970, Mr. Ballay prepared and, as with each of the others, Mr. Miller signed a memorandum of acceptance and consolidated billing approving $1,782.31 of plaintiffs' invoices for this period. Plaintiffs received no payment for any billings submitted for this period.

48. Following termination of the contract, plaintiffs' records of contract performance were investigated by agents of the Federal Bureau of Investigation (hereafter FBI) and HUD auditors. Plaintiff in good faith and without hesitation turned over his contract books for inspection by FBI agents, after being advised of his rights including his right to refuse the agents access to the books. Plaintiff was not subsequently subpoenaed, charged or indicted on any matter connected with this contract.

49. HUD auditors Mr. Allen Cash and Mr. William York each spent approximately 25 man-days from June 11, 1970 until July 16, 1970 conducting a special audit of plaintiffs' contract performance. Special audits are conducted when the Office of the HUD Inspector General receives indications of improprieties or at the request of the HUD program personnel and typically take approximately 10 man-days.

50. After their special audit of plaintiffs' contract, the HUD auditors concluded that out of plaintiffs' total unpaid billings of $47,379.47, $9,431.72 were disallowable charges

leaving HUD with $37,947.75 in unpaid billings to plaintiffs.

51. The figures presented by plaintiffs, and those approved by the local housing managers are illustrated below:

Period	Billed by Plaintiffs	Approved by Local Housing Managers, but Unpaid	Paid by D
1/31/70–2/26	$9,156.82	$8,163.89	$8,163.89
2/27–3/31	20,193.36	13,555.16	—
4/1–4/29	8,101.36	8,041.18	—
4/30–5/31	16,974.12	7,490.20	—
6/1–6/10	2,019.69	1,782.31	—
	$56,445.35	$39,032.74	
	–8,163.89	–8,163.89	$8,163.89
Bal. Unpaid	$48,281.46	$30,868.85	

The termination letter of May 28, 1970 was effective June 10, 1970.

52. The exact results of the audit are as duplicated below:

Audit Report Period January 31, 1970, to June 10, 1970		
Billings:		
Service Calls	$51,469.96	
Inspections	4,073.40	
Total Billings		$55,543.36
Less: Payments by HUD		8,163.89
Unpaid contractor billings		$47,379.47
Audit disallowances:		
Unauthorized repairs	$809.26	
Improper charges for service calls	2,170.80	
Quantities of materials billed in excess of purchases	3,538.82	
Pricing of materials in excess of cost	2,746.66	

Used material and material not furnished	166.18	$9,431.72
Unpaid billings		$37,947.75

53. The auditors attempted to verify plaintiffs' payroll records. Plaintiffs failed, however, to keep payroll records sufficient to permit a determination of the hours worked or the hourly rate of compensation or the total compensation paid individual employees. Plaintiffs' records also failed to indicate the work classifications of their employees.

54. The auditors investigated an invoice dated March 12, 1970 for a service call on HUD Trailer No. 1448, occupied by a Mrs. Alice Buras, on which invoice the Government was billed for $36.80 ($32.00 actual cost plus 15%) for a "fauset (sic) set in kitchen." The work billed on that invoice was allegedly performed by Mr. David Miller and Mr. Jack Anderson. In fact, however, plaintiffs neither paid for the water faucet nor installed it. The water faucet was purchased at Sears, Roebuck & Company by Mr. Tom Ochella, a friend of Mrs. Buras, who also installed it for her. Mrs. Buras paid Mr. Ochella a total of $30.00 for the cost of the faucet and his time and trouble in installing it. Plaintiffs never repaid Mrs. Buras for her expense on the water faucet. When plaintiffs' repairmen next visited her mobile home on another matter, she returned the broken faucet to them.

55. Plaintiffs submitted an invoice dated March 16, 1970 for a service call on HUD Trailer No. 189, occupied by one Willie Tony, for which they billed the Government for a new sofa and chair. Plaintiff David Miller told the HUD auditors that he could provide evidence supporting the purchase of a new sofa and chair for HUD Trailer No. 189. Plaintiff failed to provide any such evidence. In fact, the sofa and chair installed in HUD Trailer No. 189 were both used.

56. Plaintiffs had submitted a total of 36 invoices in excess of $50.00 for which they had failed to obtain prior approval from the Housing Manager or his deputy. The repairs involved on 12 of those invoices were such that approval would necessarily have had to have been given in

order to maintain the habitability of the mobile homes; the lack of prior approval for those was, therefore, a technical defect. Prior approval, however, should reasonably have been sought on the other 24 invoices in excess of $50. Plaintiffs billed a total of $2,031.66 on those 24 invoices of which no more than $50 is allowable cost on each invoice, and the total to be disallowed is $831.66.

57. In 216 instances, plaintiffs did additional repair work in the course of performing a periodic inspection. In each instance, plaintiffs billed the Government for both a periodic inspection and a service call. The contract provided that the contractor was to make periodic inspections of each occupied trailer at intervals of 90 days, during the course of which periodic inspection certain specified work was to be performed plus "any other needed repairs or replacements . . . subject to the cost limitation of $50.00." Service calls, on the other hand, were to be performed only when directed by the Housing Manager. The minimum fees charged by plaintiffs for periodic inspections and service calls both included an allowance for labor, travel time, and mileage. Inasmuch as periodic inspections and service calls are separate and distinct items and necessary repairs were to be done as part of a periodic inspection, plaintiffs should not have billed the Government for a service call when it did some repair work concurrently with a periodic inspection. The total amount of overbilling involved is $2,170.80, *i.e.*, 216 service call billings times the $10.05 minimum fee for a service call.

58. Plaintiffs billed the Government $37.38 for an allegedly new commode installed in HUD Trailer No. 189, occupied by one Willie Tony, whereas as set forth in Finding No. 35 C., *supra*, the commode was a used commode taken from a burned trailer and did not represent a cost to plaintiffs. Consequently, plaintiffs overbilled the Government by $37.38.

59. Plaintiffs billed the Government $92.00 (representing $80.00 cost plus 15% profit or $12.00) for an allegedly new sofa and chair installed in HUD Trailer No. 189, occupied by one Willie Tony, whereas the sofa and chair were used, were installed without authority from the

Housing Manager and, hence, were not a billable cost to the Government.

60. Plaintiffs billed the Government $36.80 (representing $32.00 cost plus 15% profit or $4.80) for a faucet set allegedly installed in HUD Trailer No. 1448, occupied by one Alice Buras, which, in fact, as testified to by Ms. Buras, was neither installed nor purchased by plaintiffs and, hence, did not represent a billable cost to the Government.

61. The evidence establishes a pattern of conduct by plaintiffs which constitutes a negligent disregard for the truth in their preparation and submission of invoices upon which the five consolidated billings under the contract were based.

62. The audit conducted by HUD showed that over the life of the contract plaintiffs negligently and irresponsibly, presented, or caused to be presented five false consolidated billings to the Government.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover $37,947.75 in accordance with the foregoing opinion. The court also concludes that the defendant is entitled to recover $10,000.00 on its False Claims Act counterclaim. Plaintiff's ultimate recovery, therefore, is $27,947.75 and judgment is entered for that amount.

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550 F.2d 629

ALLSTATE INSURANCE COMPANY v. THE UNITED STATES

[No. 380–73. Decided February 23, 1977]

ON PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AND DEFENDANT'S CROSS-MOTION FOR PARTIAL SUMMARY JUDGMENT

Taxes; income tax; limitations period on filing claims for refund; limitation on allowance of refund; limit on amount of refund;

Syllabus

interest on overpayments.—Plaintiff seeks to recover overpayments of its Federal income taxes and interest for taxable year ended December 31, 1969. On September 15, 1970 plaintiff timely filed (pursuant to an extension) its 1969 income tax return showing a total tax due in an amount in excess of the amount previously paid, and requested and received a refund; in March 1973 the IRS asserted a deficiency for 1969, which amount plaintiff paid on July 30, 1973, including assessed interest; on September 7, 1973 (within 3 years of filing its 1969 income tax return) plaintiff filed a claim for refund (first claim) for not only the amount of the deficiency but for other amounts arising from issues other than those raised in the deficiency; on September 13, 1973 this claim was disallowed in full; on October 10, 1973 plaintiff filed the present suit; on June 21, 1974 (more than 3 years after filing its 1969 tax return and within 2 years of payment of the assessed deficiency) plaintiff filed an additional administrative refund claim (second claim) which asserted a new ground for recovery and which repeated the grounds constituting the first claim; following disallowance of the second claim on June 28, 1974, plaintiff amended its petition in this court to incorporate the new portion of the second claim. Defendant concedes that except for $2,810.71, plaintiff is substantively entitled to refund of the amounts sought in both claims, but asserts that the second claim was not filed within 3 years of filing its 1969 tax return and that under Sec. 6511(b)(2)(B) of the Code, plaintiff's recovery on its second claim is limited to the amount of the deficiency plus assessed interest paid during the 2 years preceding that claim. Defendant also contends that the nonrepetitive portion of the second claim is time-barred. It is *held* that the issues raised in the first claim were timely pursuant to the 3-year provision of Sec. 6511(a); that the new issue raised in the second claim was timely pursuant to the 2-year provision of Sec. 6511(a); that the amount of the first claim, being well within the limitation of Sec. 6511(b)(2)(A) is wholly recoverable; and that since the amount of refund sought in the new issue of the second claim is less than the amount paid 2 years prior and since the second claim is within the limitation of Sec. 6511(b)(2)(B) the second claim is wholly recoverable. Plaintiff's motion for summary judgment is granted for $1,704,541.11 and judgment is entered for plaintiff in that amount. Defendant's motion for partial summary judgment is denied. Interest on the overpayments is awarded computed pursuant to Example (2) of 26 C.F.R. § 301.6611–1(c).

Taxes; claim for refund; limitations on filing claims; repetition of disallowed claim in second claim, effect of.

[1] Once a refund claim has been disallowed, it is not subject to amendment. Where plaintiff filed a second claim asserting a new ground for recovery and repeating the grounds constituting the first disallowed claim, the repetitive portion is a nullity, and the statute of limitations for the first claim remains with the first claim and is not transported to the second claim merely because of the repetition; if the first claim was filed within the 3-year period prescribed by Sec. 6511(a)

Syllabus

of the Code it is timely filed and has not lost its filing status because of a subsequent repetition.

Internal Revenue ⚖1970, 1976

Taxes; claim for refund; limitations on filing claims; 2-year limitations period of Sec. 6511(a).

[2] Where plaintiff, more than 3 years after filing its original Federal income tax return, raised an issue in a claim for refund not raised by the Internal Revenue Service in a deficiency assessment respecting said tax return, such a claim is considered timely filed within the 2-year rule of Sec. 6511(a) of the Code; it was not the intent of the Congress to limit the issues raised in a post 3-year refund claim to those issues raised in the deficiency assessment.

Internal Revenue ⚖1970

Taxes; claim for refund; limitations on allowance of credits and refunds; limit on amount of credit or refund.

[3] Where the court has determined that the issues raised in plaintiff's first and second refund claims were timely filed pursuant to Sec. 6511(a) of the Code, since the amount of tax paid respecting plaintiff's first refund claim was within the 3-year limitations period prescribed by Sec. 6511(b)(2)(A) the refund sought is wholly recoverable; and since the amount of tax paid within the 2-year period immediately preceding the filing of plaintiff's second refund claim was greater than the amount sought in said claim, the latter amount is within the limitation of Sec. 6511(b)(2)(B) and is wholly recoverable.

Internal Revenue ⚖1970, 2192

Taxes; revenue laws; construction and operation; ordinary meaning of terms.

[4] Absent some contrary indication, the court must assume that the framers of statutory provisions intended to convey the ordinary meaning which is attached to the language they used. Thus, under Sec. 6511(b)(2)(A) there exists a pool for 3-year recoveries of a tax refund and under Sec. 6511(b)(2)(B) there exists a pool for 2-year recoveries, the statute giving no indication that monies recovered within the 2-year rule should come from monies most recently paid.

Internal Revenue ⚖2192

William A. Cromartie, attorney of record for plaintiff. *Patrick A. Heffernan* and *Glen H. Kanwit,* of counsel.

Charles E. Auslander, Jr., attorney of record for defendant, with whom was *Acting Assistant Attorney General Myron C. Baum. Donald H. Olson* and *Robert Watkins,* of counsel.

Before SKELTON, KUNZIG, and BENNETT, *Judges.*

KUNZIG, *Judge,* delivered the opinion of the court:

The plaintiff, Allstate Insurance Company (Allstate), seeks to recover overpayments of Federal income taxes and interest for the taxable year ending December 31, 1969. The parties have stipulated that as a *substantive* matter, Allstate is entitled to all but $2,810.71 of the claimed refunds. However, defendant relies on Section 6511(b)(2) of the Internal Revenue Code of 1954 in contending that $127,907.18 of the refund is technically barred by the statute of limitations.[1] For the reasons hereafter described, we hold the plaintiff not barred as to any part of the contested amount. Plaintiff's motion for summary judgment is granted, and defendant's motion for partial summary judgment is denied.

Allstate's 1969 tax saga began on September 15, 1970 when, pursuant to an extension, it filed its 1969 corporate income tax return showing a total tax due of $10,538,901.34. Having previously paid the Internal Revenue Service (IRS) $10,902,000.00, Allstate claimed a $363,098.66 refund, which it subsequently received.

In March 1973, the IRS asserted against Allstate a deficiency for 1969 of $1,579,444.64 ($1,321,712.33 plus interest of $257,732.31). The alleged deficiency was paid by Allstate on July 30, 1973. Allstate filed a claim for refund ("first claim") on September 7, 1973, for the amount of $1,594,422.22. This claim included amounts alleged due from not only the payment of the deficiency, but for other amounts arising from issues other than those raised in the deficiency. The first claim was filed within three years of Allstate's 1969 filing (September 15, 1970). Within a week, on September 13, 1973, the IRS disallowed Allstate's first claim in full.

On October 10, 1973, Allstate commenced this Court of Claims action by filing a petition based entirely on the first claim.

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[1] Plaintiff seeks a total of $1,704,541.11 ($1,707,351.82 less the $2,810.71) in his motion for summary judgment. Since the Government has stipulated to Allstate's substantive entitlement to all but the amount alleged barred by a statute of limitations (the basis of the Government's cross-motion for partial summary judgment), we will only address ourselves to the statute of limitations issue. We shall avoid a discussion of the substantive merits of plaintiff's claims, including them only for purposes of computing the final judgment.

Eight and one-half months later, on June 21, 1974, Allstate filed an additional refund claim with the IRS ("second claim"). The second claim asserted a new ground for recovery (additional investment credit unclaimed on its 1969 return of $112,929.60). Importantly for this case, Allstate also repeated, in their entirety, the grounds constituting the first claim which, of course, was already before this court. The second claim aggregated $1,707,351.82 ($1,594,422.22 plus $112,929.60 from the new ground in the second claim). As will also become important for this case, the second claim was filed more than three years after Allstate's 1969 tax return was filed, but within two years of its July 30, 1973 payment of the deficiency to IRS.

On June 28, 1974, the IRS disallowed Allstate's second claim. Allstate responded by amending its petition in this court to incorporate the new portion of the second claim, bringing its total prayer for judgment to $1,707,351.82.

Defendant has conceded that except for the sum of $2,810.71,[2] Allstate is substantively entitled to a refund of the amounts sought in both the first and second claims. However, defendant asserts that Allstate's second claim was not filed within three years of plaintiff's filing of its 1969 tax return and that during the two years preceding the filing of the second claim, Allstate paid only $1,579,444.64 in income taxes. Citing Section 6511(b)(2)(B) of the Internal Revenue Code, defendant argues that Allstate's total recovery is limited by the $1,579,444.64 ceiling. The relevant portion of Internal Revenue Code §6511 for purposes of this case is hereafter set forth. It is important to note that subsection (a) prescribes *time* limitations for filing refund claims whereas subsection (b)(2) prescribes *amount* limitations.

> §6511. Limitations on credit or refund
>
> (a) Period of limitation on filing claim.—Claim for credit or refund of any overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2

[2] Allstate has stipulated that it is not entitled to this amount.

years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid. Claim for credit or refund of an overpayment of any tax imposed by this title which is required to be paid by means of a stamp shall be filed by the taxpayer within 3 years from the time the tax was paid.

(b) Limitation on allowance of credits and refunds.—

(1) Filing of claim within prescribed period.—No credit or refund shall be allowed or made after the expiration of the period of limitation prescribed in subsection (a) for the filing of a claim for credit or refund, unless a claim for credit or refund is filed by the taxpayer within such period.

(2) Limit on amount of credit or refund.—

(A) Limit where claim filed within 3-year period.— If the claim was filed by the taxpayer during the 3-year period prescribed in subsection (a), the amount of the credit or refund shall not exceed the portion of the tax paid within the period, immediately preceding the filing of the claim, equal to 3 years plus the period of any extension of time for filing the return. If the tax was required to be paid by means of a stamp, the amount of the credit or refund shall not exceed the portion of the tax paid within the 3 years immediately preceding the filing of the claim.

(B) Limit where claim not filed within 3-year period.—If the claim was not filed within such 3-year period, the amount of the credit or refund shall not exceed the portion of the tax paid during the 2 years immediately preceding the filing of the claim.

The major focal point of this dispute then is the characterization of the second claim. The Government desires us to view the second claim for statute of limitations purposes as one total claim of $1,707,351.82 without regard to the existence of a separate first claim. If we do so, the Government envisions the following results: The second claim having been filed outside of three years from the initial filing of the return, §6511(b)(2)(B) would apply and would limit the recovery of Allstate to the amount of 1969 taxes actually paid within two years of the filing of the second claim. Had no 1969 taxes been paid during this two-year period, no recovery would be allowed. Since $1,579,444.64 in 1969 taxes was paid within the two-

year period, that amount and no greater sum is recoverable. Since Allstate's second claim aggregated $1,707,351.82, $127,907.18 is time-barred.

Allstate, on the other hand, characterizes the second claim as constituting two separate claims—the first claim repeated, and the additional element of the second claim. Each of the two portions the second claim, says Allstate, has its *own* statute of of limitations. The repeated first claim portion of the second claim comes within the three-year rule of §6511(a) having been filed within three years from the filing of the original return. The additional element of the second claim, since filed outside the three-year limit of §6511(a), is bound by the two-year limit expressed in the second half of §6511(a). The upshot of Allstate's characterization is that none of the portion of the second claim representing the repeated first claim is time-barred, and therefore when considered within the rules of §6511(b)(2)(A), no amount is "amount barred." Further, the additional element of the second claim amounts to $112,929.60,[3] a sum far beneath the $1,579,444.64 ceiling (the amount of tax actually paid by Allstate in the two years preceding the second claim as per §6511(b)(2)(B)) and is, therefore, entirely recoverable. *I.e.*, the $112,929.60 is neither "time barred" nor "amount barred."

The opposing characterizations of the nature of the second claim can perhaps best be shown by diagram.

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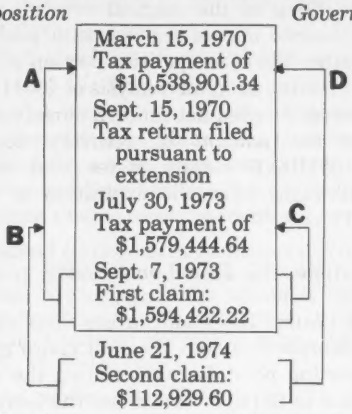
[3] Of this amount, it is agreed by both parties that $2,810.71 is not recoverable. Plaintiff's claim for the additional element of the second claim, therefore, is in reality only for $110,118.89. To avoid confusion, we will continue to refer to the additional element of the second claim as being worth $112,929.60, but will deduct the stipulated sum of $2,810.71 from the plaintiff's ultimate recovery.

CHRONOLOGY OF EVENTS



Area within box = events within three-year statute of limitations of §6511(a)

A—First claim relates back to date of tax return filing (imputed to March 15, 1970 pursuant to extension granted by IRS).

B—Second claim relates back to payments made not more than two years prior to second claim.

C—First claim relates back to date of payment of assessed deficiency.

D—Second claim must relate back to date of original tax payment because deficiency assessment exhausted by first claim.

Beyond the Government's urging that we characterize Allstate's second claim as one claim for statute of limitations purposes, it argues additionally that the non-repetitive portion of the second claim is time-barred—that it is an amount which should have been claimed within three years of the filing of the original return. The Government contends that since this non-repetitive issue of the second claim was not an issue raised by the IRS on audit or a subject of the alleged deficiency imposed in March 1973, it cannot be raised once three years from the filing of the original tax return has passed. Essentially, the argument is that Allstate may not raise an issue in a refund claim that was not raised by the IRS in a deficiency

assessment if the refund claim is filed more than three years from the filing of the original return.

Plaintiff, of course, argues the opposite position. The question of whether the non-repetitive portion of the claim is time-barred involves us in an analysis of §6511(a). If it is *in fact* time-barred, we need not concern ourselves with the limitations on the *amount* of recovery depicted in 6511(b)(2), as 6511(b)(1) clearly states that *no* refund recovery is allowable after the expiration of the time allowed in 6511(a).

Applicable Time Limitations

1. *The First Claim.* Defendant urges that the second claim, which incorporated both the first claim and a new issue, is the starting point for determining the statute of limitations period in 6511(a). Herein lies the Government's fatal error. Defendant's characterization would result in the entire subject matter of the first claim being swept within the "within 2 years from the time the tax was paid" portion of §6511(a) which would in turn activate the amount limitation of §6511(b)(2)(B) rather than §6511(b)(2)(A).

In actuality, the repetition by Allstate in its second claim, of the first claim's allegations, was a nullity. It is a rule of long standing that once a refund claim has been disallowed, it is not subject to amendment. *United States* v. *Memphis Cotton Oil*, 288 U.S. 62 (1933); *A. H. Kelson* v. *United States*, 503 F.2d 1291 (10th Cir. 1974); *Stratmore* v. *United States*, 463 F.2d 1195 (3d Cir. 1972); *Clement* v. *United States*, 405 F.2d 703 (1st Cir. 1969); *Solomon* v. *United States*, 57 F.2d 150 (2d Cir. 1932). Similarly, repetition of the identical grounds set forth in the disallowed claim in a new and subsequent refund claim is a nullity. It would be a curious rule of law which refused to allow the filing of an amended claim after rejection, but allowed an identically restated claim after rejection. Allstate's second claim, therefore, is viable *only* as to its *new portion* ($112,929.60).

The statute of limitations for the first claim remains with the first claim and is not transported to the second

merely because the latter reasserts the former. The court recognized this principle in *Charlson Realty Co.* v. *United States*, 181 Ct.Cl. 262, 384 F.2d 434 (1967). In *Charlson*, the plaintiff filed a refund claim, followed by a second claim which repeated the first claim and alleged other grounds for recovery as well. When suit was filed in this court, it was clear that the first claim was time-barred. Had the second claim been a mere repetition of the first claim, it too would have been time-barred. The court determined that the two refund claims were not identical, however, holding:

> The second claim was not a mere repetition of the first claim, but is based upon new grounds, and therefore, constitutes a separate claim which is entitled to independent treatment with reference to the statute of limitations. *Charlson Realty Co., supra*, 181 Ct.Cl. at 270; 384 F.2d at 440.

We see no construction of the facts which would lead us to a conclusion other than that Allstate's September 7, 1973 refund claim was within three years of the September 15, 1970 filing deadline and was, therefore, timely filed under the three-year portion of §6511(a).

Additionally, the Government has now conceded that Allstate is substantively entitled to the amount claimed in the first claim. (It was due to the original IRS denial of Allstate's first claim, that Allstate filed suit in this court.) Subsequent to paying the asserted deficiency, Allstate filed a new and different claim for refund, reasserting therein the grounds of the first claim for what it termed "the Government's administrative convenience." For the Government now to be allowed to twist a normal three-year statute of limitations in re the substantive issues of the first claim (thereby "earning" $127,907.18 for the Government), especially when it has conceded the merit of the first claim, would be to work a grave injustice upon the taxpayer. We hold that the first claim was filed "within 3 years from the time the return was filed," (§6511(a)) and does not lose this filing status because of a subsequent repetition of the claim.[4]

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[4] At this point, it seems fair to state that had Allstate *not* reasserted its first claim in the second claim, the Government would have no basis whatsoever to argue that the issues in the first claim acquire the statute of limitations characteristics of the

2. *The Second Claim.* As detailed above, the repetitive portion of the second claim falls within the three-year portion of the statute. We now turn to the claim for $112,929.60, the new portion of the second claim.

There is no question that the second claim was filed within two years of the time a tax was paid. The second claim was filed June 21, 1974, while the $1,579,444.64 tax payment for the deficiency assessment was made July 30, 1973. The question, to rephrase the Government's arguments, is: May Allstate raise an issue in a refund claim that was not raised by the IRS in a deficiency assessment if the refund claim is filed more than three years from the filing of the original return?

Defendant originally argued that legislative history precluded bringing such a refund claim. Yet, surprisingly, in its final brief, the Government backs away from its earlier position, stating: "The Government does not reject claims for refund, however, solely for the reason that the issues raised by the refund claim were not the basis for the deficiency assessment. Instead it allows all *valid* claims for refund based on *any* ground involving the particular tax year."[5] (emphasis in original except as to "any") Reply Brief For the United States in Support of its Cross-motion for Partial Summary Judgment and Opposition in Part to Plaintiff's Motion for Summary Judgment at 2–3. The Government's briefs, our examination of the legislative history of §6511, and our reading of the statute itself do not convince us that Congress intended to limit the issues raised in a post-three-year refund claim to those issues raised in a Governmental deficiency assessment.[6] We

second claim. Allstate claims in its briefs that the purpose of reasserting the first claim was to cater to the Government's convenience—so that the Government could view all of Allstate's claims in one document. In view of the Government's action in this case, Allstate's intention to "be helpful" has assuredly backfired. We find this unfortunate not only in terms of the problems which have befallen Allstate because of the Government's cross-motion for partial summary judgment, but also because it may well serve as a warning to other taxpayers to "not do the Government any favors."

[5] By emphasizing the word "valid," the Government appears to be making a laches-type argument. In an obfuscating argument, defendant seems to contend that set-offs to a deficiency assessment must be raised at the time of the assessment or the set-off is barred from being raised at a later time. We find no authority for this proposition, nor has the Government cited us to any.

[6] As stated above, the Government has not persuaded us on this issue, and in fact

therefore hold that Allstate's new portion of its second claim was timely filed within the two-year rule of §6511(a).

Applicable Amount Limitations

Having determined that the issues raised in the first claim were timely raised pursuant to the "three-year" provision of §6511(a) and that the new issue raised in the second claim was timely raised pursuant to the "two-year" provision of §6511(a), we now turn to the determination of the *amount limitations* on the refund claims as prescribed in §6511(b)(2)(A) and §6511(b)(2)(B).

Section 6511(b)(1) disallows *any* recovery for claims not timely filed. This, of course, need not deter us, each of Allstate's refund claims having been filed within the requisite time. Essentially, the time limitation arguments having been disposed of, the amount limitation disputes are resolved almost automatically.

Section 6511(b)(2) is bifurcated, allowing different rules for payments made within the three-year period prescribed in (a) and the two-year period prescribed in (a). Under §6511(b)(2)(A), the limitation on the amount that may be recovered in a refund claim is the amount of tax paid

eventually seems to retreat from their position. We do, however, feel it might be useful to mention Allstate's argument against adopting the Government's contention. Allstate notes that the Government has the right to setoff monies against a taxpayer's refund claim in circumstances wherein the Government could not assess a deficiency against the taxpayer because of the running of the statute of limitations. For example, in *Lewis* v. *Reynolds*, 284 U.S. 281 (1932), the Supreme Court rejected a taxpayer's refund claim despite its substantive correctness, allowing the IRS to offset monies from an unrelated issue for which the statutory period for assessment had expired. Justice McReynolds said:

> While the statutes authorizing refunds do not specifically empower the Commissioner to reaudit a return whenever repayment is claimed, authority therefor is necessarily implied. An overpayment must appear before refund is authorized. Although the statute of limitations may have barred the assessment and collection of any additional sum, it does not obliterate the right of the United States to retain payments already received when they do not exceed the amount which might have been properly assessed and demanded. (284 U.S. at 283)

The rationale of *Lewis* v. *Reynolds* is that a taxpayer should not be entitled to a refund unless he is entitled to one as a whole. While the Government may be time-barred from asserting a deficiency against the taxpayer, it may surely counter a timely refund claim with the subject of the deficiency to illustrate that *as a whole*, the taxpayer is not entitled to a refund. Allstate contends that if the *Government* has such a right of setoff against refund claims, symmetry of the tax structure is furthered by allowing the *taxpayer* to have such a right of setoff against assessments. Allstate contends that §6511 inherently includes the taxpayer's equitable right of setoff, subject only to the *amount* limitations of §6511(b).

within the three-year period after the tax return was filed, plus the period of any extension of time for filing the return (here, six months: March 15 to September 15), provided that the refund claim has been filed within that same three-year period. Under §6511(b)(2)(B), the amount that may be recovered in a refund claim is limited to the tax paid within the two-year period preceding filing of the claim, if the refund claim was filed more than three years after the tax return was filed. It is clear then that recovery on the issues raised in the first claim is to be limited by the rule of §6511(b)(2)(A), while recovery on the new issue in the second claim is limited by the rule of §6511(b)(2)(B).

Again, §6511(b)(2)(A) reads:

> Limit where claim filed within 3-year period.—If the claim was filed by the taxpayer during the 3-year period prescribed in subsection (a), the amount of the credit or refund shall not exceed the portion of the tax paid within the period, immediately preceding the filing of the claim, equal to 3 years plus the period of any extension of time for filing the return. If the tax was required to be paid by means of a stamp, the amount of the credit or refund shall not exceed the portion of the tax paid within the 3 years immediately preceding the filing of the claim.

The amount of tax paid within the period was $10,538,901.34, plus $1,579,444.64, totaling $12,118,345.98. The amount of the first claim, $1,594,422.22, being well within the limitation, is wholly recoverable.

Section 6511(b)(2)(B) reads:

> Limit where claim not filed within 3-year period.—If the claim was not filed within such 3-year period, the amount of the credit or refund shall not exceed the portion of the tax paid during the 2 years immediately preceding the filing of the claim.

The amount of tax paid within the two-year period was $1,579,444.64, and the amount sought in the new element of the second claim was $112,929.60 (less the $2,810.71 stipulated sum). The latter, being clearly within the limitation, is wholly recoverable.

The Government argues, however, that the recovery for the first claim must come from the amount most recently paid, that amount being $1,579,444.64, the amount of the

asserted deficiency. That resolution of the problem not only would obliterate the full sum available for the §6511(b)(2)(B) pool, thus denying recovery for the $112,929.60, but would also result in $14,977.58 additional being barred. (The excess of $1,594,422.22 over $1,579,444.64.)

Such a construction simply is not within the words of the statute, nor can we find support for it in the legislative history.

In the absence of some contrary indication, we must assume that the framers of the statutory provisions intended to convey the ordinary meaning which is attached to the language they used. *Rosenman* v. *United States*, 323 U.S. 658, 661 (1945).

Therefore, the ordinary meaning of the language of the statute dictates our result. There exists a pool for "three-year" recoveries, and a pool for "two-year" recoveries. The statute gives no indication that monies recovered within the "three-year" rule should come from monies most recently paid, and we refuse to give the statute such a construction here. Allstate's half of the diagram reproduced *supra*, is the correct graphic illustration of this case.

We therefore hold that all of the monies contested in this case are recoverable.

Interest

The final decision we must make is to determine the date from which interest begins running against the Government.

Recovery of interest is governed by I.R.C. §6611, and its regulations, 26 C.F.R. §301.6611–1(c). Example (2) of the Regulations provides a model for determining interest which we adapt for use in this case:

TAX LIABILITY

Original assessment	$10,538,901.34
Deficiency assessment	1,579,444.64
Total assessed	$12,118,345.98
Correct liability (total assessed less recovery in this	

case of $2,810.71)	$1,707,351.82–	–$10,413,804.87
Over assessment		$1,704,541.11

RECORD OF PAYMENTS

March 15, 1970	$10,538,901.34
July 30, 1973	1,579,444.64

AMOUNT OF OVERPAYMENTS

March 15, 1970	$125,096.47
July 30, 1973	1,579,444.64

Therefore, interest on $125,096.47 should be paid from March 15, 1970, while interest on the $1,579,444.64 is to be paid from July 30, 1973. This is precisely the interest formula urged by the Government. We agree with their formulation.[7]

Accordingly, we grant plaintiff's motion for summary judgment in the amount of $1,704,541.11 ($1,707,351.82 less $2,810.71), and judgment is hereby entered for plaintiff in that amount. The Government's motion for partial summary judgment is denied. Interest is awarded from the dates delineated, *supra*, and calculated at the rates provided by law.

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550 F.2d 636

PAUL SIDORAN v. THE UNITED STATES

[No. 425–74. Decided February 23, 1977]

ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

Military pay; continued active duty agreement; service in Vietnam.—Plaintiff seeks back pay, as well as general damages for injury to his professional reputation and emotional stress, claiming that the actions of the Secretary of the Air Force in decreeing his separation from active duty, as well as other officers in his class, for budgetary reasons and not for the state of the Southeast Asia Mission at a time when his services were still required there, constituted a breach of his

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[7] The Government seems to suggest that there might be an interest windfall here were plaintiff to demand interest on $1,579,444.64 from March 15, 1970 and interest on $112,929.60 from July 30, 1973. Allstate made no such demand. We find no windfall.

alleged continuation agreement of November 3, 1967. That agreement said he would be continued on active duty until June 30, 1969, and thereafter until the Secretary determined that the Southeast Asia Mission was such that his services were no longer required. Assuming, *arguendo*, that plaintiff had an enforceable continuation agreement, and that he received the minimum continued active duty to which he was entitled, it is *held* that the Secretary did not exceed his contractual authority in determining, as he did, that said officers' services were not required to support the Mission, since there is no commitment in the language of the agreement that the Secretary would decide to expand, maintain or cut back the Mission only in disregard of dollar outflow. Accordingly, there is no triable issue of relevant fact as to whether the Secretary's reasons were budgetary. Defendant's motion for summary judgment is granted and the petition is dismissed.

Military pay; laches; generally.

[1] Since 50 U.S.C. App. § 525 provides that the period of military service shall not be included in computing any period for the bringing of an action by a person in the service, it would thwart the purpose of this statute to make laches run for the same period.

Armed Services ⚖34.11(1)

Military pay; active duty; continued active duty agreement; termination of.

[2] Where the subject continued active duty agreement authorized the Service Secretary to determine the release of officers in plaintiff's class whenever conditions in Southeast Asia were such that their continued services were no longer required, such provision is broad enough to cover a determination to release based on budgetary considerations.

Armed Services ⚖11

David McGoldrick, attorney of record for plaintiff. *Bonneville, Viert & Morton*, of counsel.

Julie P. Dubick, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, NICHOLS and KASHIWA, *Judges*.

PER CURIAM: Plaintiff is now an Air Force Major in the reserves, and is retired. His claim for back pay is based on the following facts:

In 1967 plaintiff, then a Captain, had been passed over twice for promotion to Major and was subject to release from active duty. He was notified that a Central Continuation Board had designated him as an officer who might request continued active duty. He executed under date of

November 3, 1967, a paper reciting the foregoing and stating that he did so request. He further stated therein:

I understand that:

1. This signed certificate cannot be changed or withdrawn.
2. I will be continued on active duty until the Secretary of the Air Force determines that the Southeast Asia Mission is such that my services are no longer required.
3. The period of continuation will in no event expire before 30 June 1969 and that I will be given at least six months' notice prior to my being released from active duty.

There were other stipulations not here immediately relevant. Lieutenant Duane L. Conques signed what was designated an "Authentication" as "Unit Personnel Representative," after plaintiff's signature.

Plaintiff served in Southeast Asia until separated December 3, 1970, having been since June 27, 1970, in hospital after surgery. As early as September 22, 1969, the Secretary determined that officers of plaintiff's status were no longer required to support the Southeast Asia mission. He fixed on or before June 30, 1970, as the date for those having under 18 years active duty service to be separated. It is not denied that plaintiff on October 2, 1969, received notice that he would be separated on or before March 31, 1970, but this time was extended at his request until June 30, 1970, and the hospitalization effected the further extension.

On February 1, 1971, plaintiff voluntarily enlisted in the Air Force as a Sergeant and in 1973 retired into the reserve rank of Major, having thus completed his 20 years. He made various unsuccessful applications to the Air Force Board for Correction of Military Records (BCMR) to void his passovers and to obtain disability retirement. Those issues are not litigated here.

The instant claim is for back pay from the December 3, 1970, separation date to the retirement date, with general damages for injury to professional reputation and emotional distress. Plaintiff filed the suit on December 12, 1974. The gravamen of the suit may be said to be that the

Secretary of the Air Force breached a contract, the document of November 3, 1967, by decreeing the separation of officers in plaintiff's class for budgetary reasons and not for the state of the Southeast Asia Mission, wherein, says plaintiff, his services were still required.

Defendant moves for summary judgment and relies chiefly on laches, but we cannot sustain its position on that ground. In *Cason v. United States*, 198 Ct. Cl. 650, 461 F.2d 784 (1972), we determined that defendant could plead laches in military pay cases, relying both on reason and on some rather venerable authority. In the same case, 200 Ct. Cl. 424, 471 F.2d 1225 (1973), we reconsidered and vacated the previous judgment, on the facts of that particular case, pointing out, among other things, that the laches doctrine could not be transplanted wholesale from the litigation of civilian employees, without regard to the many differences in military life and law.

We note herein that plaintiff remained an airman on active duty, though in enlisted rank, until some time in 1973. We do not think the lapse of time from then to the institution of suit was sufficient to constitute laches, nor do we think the previous time on active duty should be counted in the computation. By 50 U.S.C. App. §525, plaintiff enjoyed a complete exemption from all statutes of limitations that might run on his claims, as long as his active duty continued. We think it would thwart the purpose of this statute to make laches run for the same period, and therefore, we decline to do it.

This commits us to the merits issues. Plaintiff says the document of November 3, 1967, was a contract authorized by 10 U.S.C. §679(a), which authorizes the Secretary to make "standard agreements" with reservists "to provide definite terms of active duty (other than for training) for reserves with their consent." Defendant denies that the continuation agreement with plaintiff was executed under that authority, but leaves us in some perplexity as it does not advise under what other authority the Secretary acted, nor does the agreement itself refer us to any. We can pass this issue by and assume, for purposes of this case only, that plaintiff had an enforceable contract. We can further assume that plaintiff got all he had coming to him, in the

way of continued active duty, unless the Secretary exceeded his contractual authority in determining, as he did, that the continued services of officers in plaintiff's class were not required to support the Southeast Asia Mission. We can assume that plaintiff could prove a breach if he could prove the separation was really ordered for some other and unrelated reason.

Plaintiff's theory however, does not offer a triable issue of fact. He says the Secretary decided as he did, not because of a change in the needs of the Southeast Asia Mission, but because of budgetary considerations. In fact, the BCMR stated in an April 10, 1972, letter to plaintiff that the action complained of was "Due to budgetary adjustments for FY 1970."

Plaintiff's fallacy is in supposing that the situation of the "Southeast Asia Mission" and the making and enforcement of budget restrictions were matters that existed in two separate universes of discourse. If we suppose that a decision had been made at the highest levels of Government that the situation in Southeast Asia mandated or permitted a winding down of the war or quasi-war in that locality, it would express itself to the Secretary of the Air Force in new budgetary stringencies. The language in paragraph 2, quoted above, is broad enough for the Secretary's determination respecting the "Mission" to be that he would spend less money upon it. There is just simply no commitment in the language used that the Secretary would decide to expand, maintain, or cut back the "Mission" only in grand disregard of dollar outflow. There is therefore no triable issue of relevant fact as to whether the Secretary's reasons were budgetary.

In view of the foregoing, and upon consideration of the record and the briefs of the parties, but without oral argument, the defendant's motion for summary judgment is sustained, and the petition is dismissed.

Syllabus

SERGEANT JOSEPH H. BROOKS v. THE UNITED STATES

[No. 302-75. Decided February 23, 1977. Plaintiff's motion for rehearing *en banc* and for alteration of the judgment denied April 1, 1977.]

ON THE PROOFS

Military pay; release from active duty; Selection Board passover for promotion; burden of proof re allegedly missing Officer Effectiveness Report when Selection Board met.—Plaintiff, a former captain in the United States Air Force Reserves, was released from active duty on June 30, 1975, on the basis of his having failed to be selected for promotion to temporary major by two Selection Boards, the latter of which met on October 7, 1974. Plaintiff challenges here, as he did before the Air Force Board for Correction of Military Records, the validity of his second passover on the ground that his Officer Effectiveness Report (OER) covering the period July 1, 1973 through January 1, 1974 was missing from his selection folder when his promotion was under consideration by the October 1974 Selection Board. This OER described plaintiff as an exceptional officer who should be promoted well ahead of contemporaries. The issue before the court is whether plaintiff's folder contained the OER when the October 1974 Selection Board met. On the basis of the evidence of record established before the trial judge, it is *held* that plaintiff has failed to carry his burden of proving by at least a preponderance of the evidence that the January OER was not in his selection folder when the October 1974 Selection Board met; that the evidence supports an inference that the January OER was in plaintiff's selection folder at all material times; and that defendant is entitled to a presumption of regularity in this matter, which presumption plaintiff has not overcome. Plaintiff is not entitled to recover and the petition is dismissed.

Military pay; promotions; courts, jurisdiction; generally.

[1] Where the promotion of an officer is within the discretion of the military, a court-ordered promotion is beyond the pale of available relief.

Armed Services ⚿7

Military pay; courts and boards; Selection Board; record before Board.

[2] Procedure for promotion selection must follow the law. The documents which are sent to a Selection Board for its consideration must be substantially complete and must fairly portray the officer's record. *Weiss* v. *United States*, 187 Ct. Cl. 1, 7, 408 F. 2d 416, 419 (1969).

Armed Services ⚿7

Syllabus

Military pay; presumptions; official actions, regularity of.

[3] In military pay cases, there is a strong presumption that military boards perform their duties correctly, fairly, and in accordance with law and governing regulations, and the burden is on plaintiff to prove otherwise. Thus, an officer contesting his passover for promotion has the burden of showing that his selection folder was incomplete as to an allegedly missing document when the second Selection Board met. This is so whether plaintiff's burden is viewed as requiring him to produce cogent and clearly convincing evidence or merely as requiring him to meet the less stringent preponderance of the evidence test.

Armed Services ⚖7
Evidence ⚖83(1)

Military pay; presumptions; official actions, regularity of.

[4] A presumption of regularity in normal, customary and standard filing practice cannot be overcome or rebutted by speculation. Thus, the date stamped on an Officer Effectiveness Report is evidence of the custom and procedure followed in placing OERs in officers' selection folders, creating a presumption that the subject OER was placed in plaintiff's selection folder on or about the date stamped thereon.

Evidence ⚖83(1)

Military pay; promotions; Selection Boards; record before Board.

[5] Absent evidence to the contrary, it is assumed that members of Selection Boards perform their duties as officers of the government in a fair and impartial manner and in accordance with law. Where, before an Air Force Selection Board convenes, selection folders of officer candidates for promotion are reviewed by designated personnel for completeness, special attention being given to Officer Effectiveness Reports to ensure that they are chronologically complete, it is reasonable to assume that if an OER were missing from a selection folder the folder-review personnel or Selection Board members would detect such omission and would correct and/or explain and/or note it. Absent evidence of any such actions, there is a presumption that Selection Boards act on a complete record.

Armed Services ⚖7

Military pay; promotions; selection folder, completeness of; burden of proof.

[6] In contesting his passover for promotion on the ground that an Officer Effectiveness Report was missing from his selection folder when the Selection Board met, it is the officer's burden to prove that the report was not in the folder at that time, not defendant's burden to prove that it was.

Armed Services ⚖7

John A. Everhard, attorney of record, for plaintiff.

Richard J. Webber, with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Per Curiam

Before COWEN, *Chief Judge*, NICHOLS and BENNETT, *Judges*.

PER CURIAM: This case comes before the court on plaintiff's exceptions to certain findings and to the conclusion of law and opinion filed on August 2, 1976, by Trial Judge Thomas J. Lydon. He held for defendant on the basis that plaintiff had failed to carry his burden of proving that a vital Officer Effectiveness Report (OER) was not in his selection folder when a Selection Board considered plaintiff on October 7, 1974, for promotion from captain to major, but passed him over. He held that the record as a whole justified an inference that the OER was in the selection folder.

By order of February 13, 1976, the court denied defendant's motion for summary judgment and remanded the case to the trial judge in an effort to establish the fact about the OER in issue. 209 Ct. Cl. 704 (1976). The court agrees with the conclusion of the trier of the facts in the case, although it also agrees with him that this is a difficult and close case and the result is painful. Plaintiff has been ably represented by an attorney recognized as an expert on military law. But, the ascertainable facts just do not support the claim, and it is plaintiff's burden to prove that they do. Plaintiff has told the court, and defendant admits, that the OER was not in plaintiff's selection folder when plaintiff examined it on January 21, 1975. But, it is mere conjecture to conclude from this that it was missing on October 7, 1974, when the Selection Board met. A date stamp on the selection folder shows the OER was filed therein on January 14, 1974, and the trial judge presumes that it remained there until examined by the Selection Board in October 1974. The Air Force Board for the Correction of Military Records had earlier declined to grant plaintiff relief based on his claim of error or injustice.

Plaintiff was rated as an "absolutely superior" reserve officer. The missing OER recommended that he be immediately promoted ahead of his contemporaries. The Selection Board had between 5,000 and 6,000 selection folders to examine. It is not unusual for qualified officers to be passed over just because there are not enough promotion

slots to be filled by promotion of eligibles. This was the second time plaintiff was passed over when he had outstanding OERs, and he was therefore released from active duty in 1975. There is no dispute over the fact that when plaintiff was considered on October 7, 1974, a more recent OER, equally flattering as the missing one for an earlier 6-month period, was in his selection folder. The trial judge holds that the OER must be presumed to have been present, absent clear proof to the contrary, that defendant is entitled to a presumption of regularity in this matter, and that plaintiff has not overcome this presumption. We adopt his opinion and findings as the basis of our judgment for defendant.*

OPINION OF THE TRIAL JUDGE**

LYDON, *Trial Judge:* Plaintiff, a former captain in the United States Air Force Reserves, was released from active duty on June 30, 1975, on the basis of his having failed to be selected for promotion to temporary major by two Selection Boards.[1] The first Selection Board convened on September 17, 1973, and the second Selection Board convened on October 7, 1974. Plaintiff challenges here, as he did before the Air Force Board for the Correction of Military Records (AFBCMR), the validity of his second passover on the ground his selection folder, placed before the October 1974 Selection Board, was incomplete when his promotion was given consideration by the board. Specifically, plaintiff complains that his Officer Effectiveness Report (OER) covering the period July 1, 1973, through January 1, 1974 (hereinafter the January OER), was missing from his selection folder when the Selection Board met. Whether this OER was in plaintiff's selection folder when the October 1974 Selection Board convened is the primary

* The dissenting opinion of Judge Bennett follows the opinion of the trial judge which has been adopted by the court.

** The trial judge's findings of fact, copies of which have been distributed to the parties, are not printed, as those essential to the decision appear in the opinion which follows.

[1] At the time of his separation on June 30, 1975, plaintiff reenlisted in the United States Air Force in the grade of sergeant, and was serving on active duty with the Air Force in said grade at the time of trial.

issue to be decided at this time.[2] A selection folder contains pertinent records of an officer deemed necessary for promotion consideration. Such a folder would contain, *inter alia*, appropriate OERs, a photograph of the officer, citations and decorations.

On the basis of the findings of fact, it is concluded that plaintiff has failed to carry his burden of establishing by at least a preponderance of the evidence that the January OER was not in his selection folder when the October 1974 Selection Board met. Moreover, the evidence of record supports an inference that the January OER was in plaintiff's selection folder at all material times.

OERs are issued periodically and rate the duty performance of an officer over a specified period of time. Two OERs were rendered, relative to plaintiff's duty performance, between the conclusion of the first Selection Board and the convening of the second Selection Board. The first OER, and the critical one in this case, covered, as indicated previously, the period July 1, 1973, through January 1, 1974. This January OER gave plaintiff the highest possible rating and recommended "prompt promotion." It noted that plaintiff's performance was "clearly outstanding." The second OER covered the period January 2, 1974, through August 1, 1974 (hereinafter the August OER). The August OER gave plaintiff the highest possible rating and recommended "immediate promotion." It noted that plaintiff's performance was "absolutely superior." Both OERs noted that plaintiff had "Outstanding Growth Potential Based On Demonstrated Performance," and that he should be promoted "Well Ahead Of Contemporaries." The format

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[2] This was the issue framed by the court in its order of February 13, 1976, when it denied defendant's motion for summary judgment and remanded the matter to the trial judge for further proceedings (209 Ct. Cl. 704 (1976)). It should also be observed that the relief available to a plaintiff in cases of this type has certain limitations. A court-ordered promotion to the grade of major is beyond the pale of available relief. *See Yee* v. *United States*, 206 Ct. Cl. 388, 398, 399–400, 512 F.2d 1383, 1388–389 (1975). Further, since there is no allegation nor proof that the first Selection Board proceedings were defective in any way, no basis exists, in any event, for removal of the first passover from his military records, as requested by plaintiff. *See Clinton* v. *United States*, 191 Ct. Cl. 604, 606, 423 F.2d 1367, 1368 (1970). As to promotion nonselection, or passover, generally see J. Glosser & K. Rosenberg, *Military Correction Boards: Administrative Process And Review By The United States Court of Claims*, 23 AM. U. L. REV. 391, 402–05 (1973).

and tone of both OERs were significantly similar. There is no dispute as to the fact that the second OER was in plaintiff's selection folder when the second Selection Board met in October 1974. It is also clear that an OER is considered to be the most important document in a selection folder. The record also suggests that generally the most recent OER carries more weight than a preceding OER when an officer's performance is being evaluated.[3]

As a starting point, the following admonition in *Weiss* v. *United States*, 187 Ct. Cl. 1, 7, 408 F.2d 416, 419 (1969), seems appropriate:

> * * * the selection procedure must follow the law. The documents which are sent to a Selection Board for its consideration therefore must be substantially complete, and must fairly portray the officer's record. * * *.

Unlike other cases which have dealt with challenges to Selection Board proceedings,[4] the record in this case is such

[3] Defendant suggests that even assuming *arguendo* that the January OER was not in the selection folder when the Selection Board met, such a deficiency, under the circumstances, constituted harmless error. *See Gratehouse* v. *United States*, 206 Ct. Cl. 288, 296, 512 F.2d 1104, 1108 (1975), and cases cited therein. *See also Doggett* v. *United States*, 207 Ct. Cl. 478, 483 (1975). Defendant argues that both the January and August OERs gave plaintiff the highest rating. Both OERs were similar in all material respects. Since the last OER is considered the most critical one in the promotion evaluation process, the fact that it was before the Selection Board and the fact that it was similar, if not slightly more favorable in tone, to the missing January OER, supports a view that its absence did not constitute prejudicial error. This argument rests on the assumption that the January OER really was immaterial, under the circumstances, and nonselection would have occurred whether the January OER was in or out of the selection folder when the Selection Board met. As a result, defendant maintains that the admonition set out in *Weiss* v. *United States*, 187 Ct. Cl. 1, 7, 408 F.2d 416, 419 (1969), quoted *infra*, has been met since plaintiff's records did "fairly portray the officer's record." While this argument has some appeal, it is not necessary to accept or reject it since the conclusion reached herein is that the January OER was before the October 1974 Selection Board.

[4] Most challenges to Selection Board proceedings center on the presence in the selection folder of improper derogatory materials. *See Armstrong* v. *United States*, 205 Ct. Cl. 754 (1974); *Brenner* v. *United States*, 202 Ct. Cl. 678 (1973), *cert. denied*, 419 U.S. 831 (1974); *Weiss* v. *United States*, 187 Ct. Cl. 1, 408 F.2d 416 (1969). In *Yee* v. *United States*, 206 Ct. Cl. 388, 512 F.2d 1383 (1975), there was no question but that the selection folder contained no OERs for a 5-year period. The fatal flaw in *Yee* was the absence from the selection folder of any explanation and/or justification for the lack of OERs covering the officer's duty performance over a 5-year period. In *Boyd* v. *United States*, 207 Ct. Cl. 1 (1975), *cert. denied*, 424 U.S. 911 (1976), the issue centered on whether the last OER in a selection folder was so inconsistent in and of itself as to vitiate a separation action by the Assistant Secretary of the Air Force, which action rejected recommendations of the Air Force Board for the Correction of Military Records favorable to *Boyd*.

that one cannot state with absolute certainty whether or not the January OER was in plaintiff's selection folder when the Selection Board met in October 1974.[5] As a result, the conclusions reached herein reflect a blend of facts, presumptions, and inferences, tempered by an awareness of which party must shoulder the ultimate burden of proof. Under such circumstances the final determination reached is painful regardless of which way it goes.[6]

In military pay cases, there is a strong presumption that military boards perform their duties correctly, fairly and in accordance with law and governing regulations, and the burden is on plaintiff to prove otherwise. *Boyd* v. *United States*, 207 Ct. Cl. 1, 9 (1975), *cert. denied*, 424 U.S. 911 (1976); *Cooper* v. *United States*, 203 Ct. Cl. 300, 304–05 (1973). Indeed, in this case, the burden was on plaintiff to show that the January OER was not in his selection folder when the Selection Board met in October 1974. *Brenner* v. *United States*, 202 Ct. Cl. 678, 690 (1973), *cert. denied*, 419 U.S. 831 (1974). Plaintiff has failed to carry that burden in this case. And this is so whether plaintiff's burden is viewed as requiring him to produce "cogent and clearly convincing evidence," *see Armstrong* v. *United States*, 205 Ct. Cl. 754, 761 (1974); *Stephens* v. *United States*, 174 Ct. Cl. 365, 371–72, 358 F.2d 951, 954 (1966), or merely as requiring him to meet the less stringent preponderance of the evidence test. *See Morris* v. *United States*, 171 Ct. Cl. 220, 228 (1965).

Following notification that he had been passed over a second time and that he was to be separated from the Air

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[5] In *Rawlins* v. *United States*, 197 Ct. Cl. 972 (1972), a congressional reference case, a material document found to be missing from Commander Rawlins' personnel folder in 1949 (explanatory of certain derogatory information in said file), was held, on the basis of a reasonable inference drawn from the record as a whole, not to have been in his personnel folder during the period 1943–50 when Commander Rawlins, on a number of occasions, was considered for promotion to the grade of captain.

[6] It is well to bear in mind that separation from the military service because of two passovers does not reflect adversely, nor should it, on the duty performance of the separated officer. It results solely from the fact that only a relatively few promotion slots are available for filling from a selection pool of thousands of officers. It is obvious that all the officers considered, even those highly rated, cannot be promoted. *Brenner* v. *United States*, *supra*, 202 Ct. Cl. at 692; *Boyd* v. *United States*, *supra*, 207 Ct. Cl. at 12.

Force, effective June 30, 1975, plaintiff examined his selection folder and microfiche records[7] on January 21, 1975. This examination disclosed that neither the selection folder, which reposed inside a housing jacket when filed, nor the microfiche records contained his January OER. There is no dispute as to the fact that on January 21, 1975, his selection folder did not contain his January OER and his microfiche records did not contain a microfilm copy of this OER. From these established facts, plaintiff infers that the January OER must have been missing from his selection folder when the Selection Board met in October 1974. The record will not support such an inferential leap.

The record discloses that the January OER was filed in plaintiff's selection folder on January 14, 1974. This fact is supported by the January 14, 1974, date stamped at the top of the second page of this OER, which stamped date, reflecting normal, customary, and standard practice and procedure, indicates the OER was placed in the selection folder on or about that date.[8] Once in the selection folder, it is reasonable to assume it remained there until the Selection Board convened in October 1974 and was in said

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[7] A microfiche is a clear plastic card to which are affixed a series of microfilmed squares. A standard three-page OER would, when microfilmed, consist of three microfilmed squares. These OER squares would be arranged on the microfiche card in chronological sequence. A new card would be prepared if an omission of an OER from the microfilm process was later remedied.

[8] Plaintiff speculates that while the date stamped thereon indicates that the January OER was placed in a selection folder on said date, the OER could have been placed in someone else's selection folder. A presumption of regularity in normal, customary and standard filing practice cannot be overcome or rebutted by speculation. *Charlson Realty Co. v. United States*, 181 Ct. Cl. 262, 278, 384 F.2d 434, 444 (1967). Further, plaintiff misreads *Charlson Realty* when he advances that decision as supporting his position. In that case, the court observed: "Actually the file stamp on the envelope or petition is nothing more than evidence of the method of procedure, habit and custom followed by the officers of the court in handling papers delivered to them in the proper discharge of their official duties. Such evidence adds nothing to the well-recognized presumption that public officers perform the duties of their office in a proper manner. But the cases hold that such a presumption will not overcome nor rebut the presumption of the arrival of a letter in due course of the mails." 181 Ct. Cl. at 275, 384 F.2d at 443. Here, the date stamped on the OER is evidence of the custom and procedure followed in placing OERs in selection folders, creating a presumption that the January OER was placed in plaintiff's selection folder on or about the date stamped thereon. Unlike the situation in *Charlson Realty*, there is no stronger presumption here to override or rebut the relied-upon presumption. There is no evidence of record which would serve to require that this presumption of regularity be ignored.

folder until some time after the Selection Board terminated.

Generally, when personnel records such as OERs were received at the Records Maintenance Branch (RMB) at Air Force Military Personnel Center (AFMPC), Randolph Air Force Base, Texas, said records were sent first to the Microform Records Branch (MRB) at AFMPC where microfilm copies of those records were made. Thereafter, the records were returned to RMB, for filing in the selection folder, with the date this was done stamped, as indicated above, at the top of the second page of OERs. However, in the case of the January OER, it was not sent to MRB but instead went directly to plaintiff's selection folder.[9] Plaintiff seizes upon this deviation from general practice to challenge the utilization of any presumption of regularity relative to the filing in the selection folder of the January OER. While the practice of microfilming incoming records first was generally desired practice, the record reveals that it was not rigidly followed. First, if a Selection Board was scheduled to meet within a 6-week period, all incoming records, including OERs, went directly into the selection folder and were microfilmed after the Selection Board terminated. Second, the record suggests that it was not unusual for records to be filed in the selection folder without first being microfilmed. In the trial record was a "Microform Flag" card which was used to identify records in selection folders which had not been microfilmed. This card, designed for multiuse, strongly suggests that microfilming incoming records first before placing them in selection folders was not as systematic a practice as plaintiff would have one believe. Further, the submission of incoming records to MRB for microfilming was separate and independent from placing said records in the selection folder. Microfilming merely delayed the actual date that

[9] A plausible and reasonable explanation of this was given at the trial by a knowledgeable witness closely associated with records maintenance and operations at RMB at the time in question. Personnel clerks at RMB were instructed not to send on for microfilming the incoming records of any officer scheduled to be separated from active duty on or before June 30, 1974. This instruction reflected an economy move at AFMPC. A clerk ostensibly erroneously considered plaintiff to be such an officer and sent the January OER directly to his selection folder instead of first routing it to MRB for microfilming.

said records were placed in the selection folder. It had no other effect on the placement of a record, such as an OER, in the selection folder. Under the circumstances, failure to microfilm the January OER before filing it in plaintiff's selection folder does not detract from the presumption of regularity which the record suggests should attach to the filing on January 14, 1974, in plaintiff's selection folder of the January OER. The fact that this OER was not microfilmed in January 1974 serves to explain, as will be discussed later, why the January OER was not in the selection folder when it was examined by plaintiff on January 21, 1975.

In August 1974, plaintiff's August OER was received by RMB. It was microfilmed before being placed in plaintiff's selection folder. There was no review of the selection folder involved in these activities and so the fact that the January OER had not been microfilmed would not surface at this time. On the microfiche card, the microfilm squares of the August OER were placed in positions that would have been occupied by the January OER had it been microfilmed in January 1974. Since the January OER had not been microfilmed, it did not appear on the August 1974 microfiche card. As a result, when plaintiff examined the August 1974 microfiche card on January 21, 1975, he understandably did not see thereon the January OER.

Although not crystal clear, the record suggests that during the review process of preparing selection folders for Selection Board consideration, personnel at RMB, or perhaps board personnel, noted that the January OER had not been microfilmed and "flagged" the document for microfilming at the conclusion of Selection Board proceedings.[10]

The record does not indicate precisely when the January OER was removed from plaintiff's selection folder. The record clearly reveals that the January OER was in the microfilm-microfiche process at MRB from December 16, 1974, to February 7, 1975, at which time it was returned to

[10] Each microfilmed document was stamped with index review numbers at the top right-hand corner of each page. As a result, a reviewer could tell at a glance whether a document had been microfilmed. These index review numbers also enable one to determine the date on which the document was microfilmed.

plaintiff's selection folder. This serves to explain why the January OER was not in plaintiff's selection folder[11] nor on his August 1974 microfiche cards when plaintiff examined the folder and the cards on January 21, 1975.

Plaintiff seeks to exploit the fact that a microform card was not in the selection folder or housing jacket, indicating that the January OER had been removed for purposes of the microfilm-microfiche process. He argues that the absence of this charge-out card supports a presumption that the January OER was never in the selection folder. Plaintiff presumes too much. It is unreasonable to assume, as one must if one is to accept plaintiff's presumptions and assumptions, that the January OER was not filed in plaintiff's selection folder on January 14, 1974, despite the date stamped thereon indicating it was so filed, that it reposed in some other selection folder, or at some other location, until December 16, 1974, when it was placed in the microfilm-microfiche process, and then placed in plaintiff's selection folder on or about February 7, 1975. There is not a scintilla of evidence in the record which would give credence to this hypothesis.

In *Brenner* v. *United States, supra,* the court stated:

> We must assume in the absence of evidence to the contrary that the members of these selection boards performed their duties as officers of the government in a fair and impartial manner and in accordance with law, and that in so doing they gave the plaintiff due and proper consideration along with all of the other candidates for promotion. * * *. (202 Ct. Cl. at 692.)

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[11] Generally, when a document is removed from a selection folder, a microform flag, a yellow standard paper-size card, or charge-out slip, is placed in the housing jacket in which the selection folder is filed. While the testimony of plaintiff is that the selection folder had no microform flag in it, no mention was made of the housing jacket, the substance of the testimony of plaintiff and Lt. Col. Victor A. Prosper, Chief of the Officer Promotion and Regular Appointment Branch at AFMPC, supports a finding that no microform flag or charge-out slip was in the housing jacket on January 21, 1975. Colonel Prosper was unable at the time to account for the missing OER, and it is unreasonable to assume that he would not have noticed a microform card, or charge-out slip, if one were in the housing jacket at the time. However, under the circumstances, this clerical oversight, while troubling, cannot obviate the fact that the January OER was in the microfilm-microfiche process from December 16, 1974, to February 7, 1975, and this fact serves to explain why it was not in the selection folder on January 21, 1975, when it was examined by plaintiff.

Before selection boards convene, selection folders of all officer candidates for promotion are reviewed by RMB personnel for completeness. Special attention is given to OERs to ensure they are chronologically complete. This emphasis on OERs in the selection folder review process gives recognition to the fact that OERs are considered to be the most important documents in the selection folder. If OERs are missing steps are taken to find the missing document or explain its absence. Before the Selection Board, the selection folders are again reviewed and board members note omissions, misfilings and other errors they discover in their review endeavors. A record is maintained by the board of noted errors and said record of errors is turned over to RMB for purposes of eliminating errors in the future. The number of errors found by the board was generally extremely low. The record in this case does not contain any record of the errors, if any, found by the October 1974 Selection Board.

Since OERs are so important, a missing OER, disruptive of the normal chronological sequence of OERs, would undoubtedly stand out in any review process. Under these circumstances, it seems reasonable to assume that if the January OER was missing from plaintiff's selection folder it probably would have been detected by RMB personnel in reviewing the selection folder, preparatory to the meeting of the Selection Board, or by board personnel in their review of the selection folder. There is no contrary evidence to rebut the presumption that the Selection Board performed its duties correctly and that if the January OER was missing from plaintiff's selection folder such an omission would have been detected and corrected and/or explained and/or noted. The absence of any such action by the Selection Board, on this record, warrants acceptance of the presumption that the Selection Board acted on a complete record, which included the January OER, when it considered plaintiff for promotion. *Biddle* v. *United States*, 186 Ct. Cl. 87, 104 (1968); *see also Armstrong* v. *United States*, *supra*, 205 Ct. Cl. at 762–63.

On the basis of the entire record, it is concluded that plaintiff has failed to carry his burden of proving that the January OER was not in his selection folder when the

Selection Board convened in October 1974. *Brenner* v. *United States, supra,* 202 Ct. Cl. at 690. It is not defendant's burden to prove that the January OER was in the selection folder, rather it is plaintiff's burden to prove that it was not in the selection folder when the Selection Board met. *See* MCCORMICK ON EVIDENCE §§306, 307 (1954). Moreover, the record as a whole supports an inference that the January OER was in his selection folder when the Selection Board reviewed it for promotion purposes. *See Armstrong* v. *United States, supra; Biddle* v. *United States, supra.*[12]

BENNETT, *Judge,* dissenting:

The court holds that plaintiff has not met his burden of proof and that his claim is supported only by conjecture. The court frankly admits its difficulty with this conclusion and so do I. The case comes down to a question of what it takes to overcome the presumption of procedural regularity that defendant enjoys in the conduct of its business. In turn, the answer must depend on the facts of the case. In the present case it seems to me that defendant has a certain burden to start with and that it is not all plaintiff's. As our order of February 13, 1976, shows, the pertinent Air Force regulations "clearly require that a selection jacket contain OERs not duly stricken by appropriate authority." Defendant does not claim that the OER in issue here has been so stricken. Plaintiff has offered cogent proof to rebut the presumption that the allegedly missing OER was, in fact, not missing on the date the Selection Board was charged with considering it to determine whether plaintiff would be promoted. This proof shifts the burden to

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[12] As a result of this holding, the decisions by the AFBCMR denying plaintiff's applications for correction of his military records cannot be considered arbitrary, capricious or otherwise defective in law or fact. Accordingly, there is no need to give consideration to defendant's suggestion that jurisdiction of this court to review AFBCMR actions, which actions are governed by 10 U.S.C. §1552 (1970), is lacking because, in defendant's view, section 1552 does not mandate relief by way of a money judgment for the failure of the AFBCMR to correct a record, citing *United States* v. *Testan,* 424 U.S. 392 (1976). *But see Armstrong* v. *United States, supra,* 205 Ct. Cl. at 761. *See also Yee* v. *United States, supra.*

defendant to show that the OER in question was before the Selection Board.

The trial judge and the court decry plaintiff's "inferential leap" which jumps to a conclusion that because the OER was missing on January 21, 1975, it was missing on October 7, 1974. That leap spans just over 3 months. But, the trial judge says that since the file stamp discloses the OER was presumably put in the selection folder on January 14, 1974, "it is reasonable to assume it remained there until the Selection Board convened in October 1974 and was in said folder until some time after the Selection Board terminated." This is an inferential leap of 9 months. This jumping contest makes plaintiff's claim the more credible. The preponderance of the evidence on this point, such as it is, is in plaintiff's favor. If we must presume what happened, it is plainly easier to go with plaintiff's presumption.

In overcoming any presumption in defendant's favor, plaintiff, in a case such as this, is under the handicap that all the witnesses and records are defendant's, and under defendant's complete control and custody at all times. Plaintiff's burden of proof must be measured in light of this difficulty, and in light of defendant's obligation to deal fairly and to turn square corners with its citizens. The trial judge admits that his conclusions are reached to "reflect a blend of facts, presumptions, and inferences." If a credible showing can be made by plaintiff to demonstrate that defendant has not followed its regular procedures, this should overcome the defendant's advantage of a presumption of regularity, especially when the presumption is supportable only by inferences. Plaintiff has shown that between the time his selection folder was considered by the board in October 1974 and when plaintiff examined it in January 1975, had the OER been removed there would have been a "charge-out" card inserted in the record. There was none, and the trial judge so found. This strongly suggests that the content of the file was the same in October as it was in January. Defendant's witness who was present at the January examination of the folder could not explain this absence of the charge-out card. He recommended that plaintiff seek relief from the Correction

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Board. Defendant's regular procedures were not followed and this overcomes any presumption of regularity that they were.

Another undisputed fact in plaintiff's favor is that it was customary for defendant to microfilm an OER and then file it in the selection folder. That was not done here. Plaintiff's OER was not microfilmed until December 16, 1974, long after the promotion Selection Board had adjourned. It was not added to his file until February 7, 1975. Defendant says that this is just a clerical error and not unusual and that absence of the OER when plaintiff examined his file is accounted for by the fact that it was being microfilmed at the time. If so, where was the charge-out card for this purpose? Its absence remains unexplained. Presumption of regularity ceases when irregularity is clearly demonstrated in record keeping. Error and irregularity pervade defendant's case. The trial judge says: "The record does not indicate precisely when the January OER was removed from plaintiff's selection folder."

With all due respect, plaintiff has made a case and should be entitled to recover.

CONCLUSION OF LAW

Upon the foregoing opinion and the findings of fact which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover and the petition is dismissed.

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550 F.2d 639

COAST INDIAN COMMUNITY v. THE UNITED STATES

[No. 850–71. Decided February 23, 1977]

ON THE PROOFS

Indian claims; taking of Indian property; breach of fiduciary obligation; compensable interest; valuation of right-of-way; consents to right-of-way conveyance; unauthorized act of agents.—Plaintiffs seek damages from the United States for an alleged under-

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compensated taking of their property and a breach of fiduciary obligation owed them by the Bureau of Indian Affairs (BIA) as an agent of the United States. By deed dated January 7, 1938, a 228-acre tract of land (Rancheria) situated along the south bank of the Klamath River in Del Norte County, California, was conveyed by the United States in trust for such Indians of Del Norte and Humboldt Counties eligible to participate in the benefits of the Indian Reorganization Act of June 18, 1934 "as shall be designated by the Secretary of the Interior." The BIA purchased the tract and in 1939 the Acting Secretary of the Interior proclaimed the land an Indian reservation. Beginning in 1938 13 eligible Indian families took up residence on the Rancheria, becoming known as the Coast Indian Community. Due to a flood in December 1964 all but two families were forced to relocate; the other two families moved off the land when their homes burned in 1969 and 1971, respectively. Since 1971 no one has lived permanently on the Rancheria, but most of the former residents have used the Rancheria for camping and gardening, remaining there during the summer and fall of the year. In March 1965 the BIA issued an annual revocable permit to a lumber processing mill (Simpson) allowing Simpson to transport timber across the Rancheria; Simpson was charged 25¢ per 1,000 board feet, the fair rental value of the right-of-way as determined by a BIA appraiser. Simpson desired a permanent right-of-way, and the County, having obtained Simpson's agreement to pay all costs of acquiring and building the road sought, applied for and was granted the easement; on April 5, 1966 the BIA sold the right-of-way to the County for $2,500. Plaintiffs assert that the right-of-way, valuable because it provided the most direct access to a large redwood and Douglas fir timbering area, was conveyed by the United States as trustee for the reservation land for a grossly inadequate consideration, being worth approximately $57,000. It is *held* (1) that record evidence establishes that by April 1966 plaintiffs had been "designated" the beneficial owners of and have a compensable interest in the Rancheria, including the right-of-way at issue, within the meaning of the 1938 deed and the 1939 proclamation; (2) that plaintiffs' expert appraiser was a good, reliable, credible, highly qualified expert witness on valuation, that his testimony was legally and factually wellfounded, and that his land valuation of $50,000 representing right-of-way fees lost because of the conveyance and which should have been paid to the BIA in trust for plaintiffs is appropriate; (3) that severance damages under the facts are not allowable; (4) that the BIA violated the restrictions contained in the statute and regulations because the BIA failed to obtain the consent of a majority of the adult members of the Community which was a prerequisite to the BIA making the right-of-way conveyance; since there is no evidence of ratification of this wrongful act by the BIA the sovereign cannot be held liable under the fifth amendment; (5) that plaintiffs did not hold legal title to the Rancheria; (6) that plaintiffs are entitled to recover for the Government's negligent conduct in the valuation of the right-of-way for sale to the County, as evidenced by the gross inadequacy and incompetence of the appraiser employed by the

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BIA, and by the wide disparity between market value and price; and (7) that the United States, failing to act in the manner meeting the high fiduciary standards imposed upon it when dealing with Indian property, must pay in damages for the breach of its trust obligations in an amount equal to the full market value that should have been realized by the sale ($50,000), less $2,500 actually paid, and judgment is entered to this effect. Further proceedings will be held to determine the beneficiaries entitled to share in the award and whether interest is awardable.

Indian claims; land; reservation or granted land; title and rights acquired; beneficial owners; implied by positive acts of Government

[1] Where a tract of land was conveyed by deed in 1938 to the United States as trustee for Indians of Del Norte and Humboldt Counties eligible to participate in the benefits of the Indian Reorganization Act "as shall be designated by the Secretary of the Interior" and the tract was declared an Indian reservation by proclamation in 1939, since no specific procedures for accomplishing the designation were prescribed, designation by formal proclamation listing all beneficiaries by name was not required. Absent such prescribed procedures, the conduct of the Bureau of Indian Affairs in locating the Indians on the land, in acquiescing in their continued presence on and use of the land for many years, in building houses for them on the land, and in providing them with services usually accorded Indians living on a reservation, provides strong and uncontroverted evidence of their designation as the beneficiaries within the meaning of the deed and proclamation. On such evidence, designation may be inferred by law.

Indians ⚿12

Evidence; judicial notice.

[2] The court may take judicial notice of publication on three successive weeks in a newspaper of general local circulation of a roster of voters complying with the requirements of 25 C.F.R. § 242.3 governing California rancheria or reservation distribution elections pursuant to the Rancheria Act, as constituting a public, official act of the Government, one that is capable of ready and accurate determination by resort to sources whose accuracy cannot be questioned.

Evidence ⚿45

Eminent domain; just compensation; measure of compensation.

[3] The guiding principle of just compensation is reimbursement to the owner for the property interest taken. He is entitled to be put in as good a position pecuniarily as if his property had not been taken; he must be made whole but is not entitled to more; he is entitled to fair market value but that term is not an absolute standard nor an exclusive method of valuation.

Eminent Domain ⚿122

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Indian claims; taking of Indian property; compensable interest; severance damages.

[4] Severance damages represent the deterioration in value of the owner's remaining property caused by the transfer of property rights to a part of the land. Absent sufficient showing that the value of plaintiff-Indians' property was decreased as realty used for recreational, agricultural and temporary residential purposes after establishment of the right-of-way, compensable severance damages are inappropriate.

Eminent Domain ⚖205

Eminent domain; taking; authority of Government agent.

[5] In order for a taking to occur by virtue of the act of a Government agent, the agent's act must be accomplished within the scope of his statutory or delegated authority, and it must invade private property rights in such a manner and degree that compensation may fairly be said to be due under the fifth amendment. The character of the interest must be judged on the facts of each case, but a determination that there was an invasion requires at the minimum a showing that private property rights existed in the claimant. Absent a showing that the agent acted within the scope of his authority, there can only be a tortious trespass, for which the fifth amendment does not require compensation by the sovereign.

Eminent Domain ⚖69

Indian claims; taking of Indian property; act of Government agent.

[6] Appropriations of Indian lands by the acts of Government agents, mistaken or tortious in origin, are takings within the fifth amendment only if Congress was informed of the encroachments and ratified them, expressly or by inaction, or the President ratified the Government's acquisition of the lands with the full knowledge and acquiescence of Congress.

Eminent Domain ⚖2(1)

Indian claims; land; rights-of-way through Indian lands; act of Government agent.

[7] Where the local Bureau of Indian Affairs officials were legally bound to follow the statutory and regulation-based procedures in the course of executing the conveyance of the subject right-of-way, any conveyance in violation of those procedures amounted to an unauthorized, void and wrongful act, for which the sovereign bears no responsibility under the fifth amendment. Since the Rancheria falls within the description of "individually owned land" of 25 C.F.R. § 161.3(b) and within the purview of § 161.1(b), and since the members' interests in the Rancheria were undivided and equivalent, consents of a majority of the adult members were a prerequisite to the authority of the BIA to make the right-of-way conveyance.

Indians ⚖15(2)

Indian claims; fiduciary obligation of Government to Indians; breach of obligation; what constitutes.

[8] The actions of the Government in its role as a trustee of Indian property must be judged according to the standards applicable to a

Per Curiam

trustee engaged in the management of trust property. The United States is held to the most exacting fiduciary standards which extend equally to the local agents of the BIA; the responsibility of the trustee includes accountability for the acts of those agents, even where wrongful and unauthorized. Gross negligence in the conduct of the United States or its agents makes the Government liable for damages in breach of its trust obligations growing out of such negligence. Thus, where the value realized from the subject right-of-way conveyance was far below the fair market value and was due to the gross negligence of the local BIA officials and to the BIA appraiser, the United States failed to act in a manner consonant with the said fiduciary standards.

Indians ⚖15(2)

Indian claims; interest on awards; breach of trust.

[9] It is well established that interest from the date that the claim arises until date of judgment is not awarded as part of a recovery for breach of trust, unless interest is prescribed by statute or express agreement.

United States ⚖110

Art Bunce, attorney of record, for plaintiff. *George Forman*, of counsel.

Hubert M. Crean, with whom was *Assistant Attorney General Peter R. Taft*, for defendant. *Rembert A. Gaddy*, of counsel.

Before DAVIS, KASHIWA and KUNZIG, *Judges*.

PER CURIAM: This case comes before the court on defendant's exceptions to the recommended decision of Trial Judge Charlotte P. Murphy, filed January 9, 1976, pursuant to Rule 134(h), having been submitted on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's recommended decision, with a minor modification, as hereinafter set forth, it hereby affirms and adopts the said decision, as modified, as the basis for its judgment in this case. It is therefore concluded that, in accordance with the trial judge's recommendation, plaintiffs are entitled to recover the net amount of $47,500 and judgment is so entered for plaintiffs with further proceedings to be held pursuant to Rule 131(c) in order to determine the beneficiaries who are entitled to share in this award and whether interest is awardable.

OPINION OF TRIAL JUDGE

MURPHY, *Trial Judge:* Plaintiffs are members of an unincorporated association known as the Coast Indian Community. They seek damages from the United States in the amount of $54,500, plus interest from April 5, 1966, for an undercompensated taking of their property and a breach of fiduciary obligation owed plaintiffs by the Bureau of Indian Affairs (hereafter BIA), as an agent of the United States.

Plaintiffs assert, as the basis for their claim, that a right-of-way across their reservation, valuable because it provided the most direct access to a large redwood and Douglas fir timbering area, was conveyed by the United States as trustee for the reservation land to the County of Del Norte, California, for a grossly inadequate consideration. According to plaintiffs, the right-of-way, worth approximately $57,000, was sold by the BIA agents for $2,500.

The factual issues in this case concern the valuation of the right-of-way and the validity of consents to the right-of-way sale, allegedly executed by three Coast Indian Community members (two now deceased). The legal adequacy of those consents and the necessity in law for obtaining them are likewise in contention. Three additional questions of law are also in dispute: whether the plaintiffs own a compensable interest in the Resighini Rancheria (hereafter Rancheria); whether the value obtained for the easement by the BIA amounts to a taking of property without sufficient compensation or a breach of fiduciary duty owed to the plaintiffs, or neither; and whether, if relief is forthcoming, the judgment should include interest from April 5, 1966, the date of the sale to Del Norte County (hereafter County).

Trial was held in Eureka, California, for 3 days and the court made an on-site inspection of the land in question, the surrounding timberland, and the lumber processing plant across the Klamath River at Klamath, California. For reasons hereafter discussed, the court holds for plaintiffs.

I.

By deed dated January 7, 1938, a tract of land known as the Rancheria was conveyed to the United States:

> * * * in Trust for such Indians of Del Norte and Humboldt Counties, in California, eligible to participate in the benefits of the [Indian Reorganization] Act of June 18, 1934 (48 Stat. 984) [25 U.S.C. §§461 *et seq.* (1970)], as shall be designated by the Secretary of the Interior * * *.

The 228-acre site, situated along the south bank of the Klamath River in the County, was purchased by the BIA under the authority of the cited statute, and proclaimed an Indian reservation by the Acting Secretary of the Interior in 1939.[1] Beginning in 1938, at the invitation of an agent of the BIA, certain Indian families of Del Norte and Humboldt Counties took up residence on the Rancheria. Some 13 Indian families of various tribal origins lived there and came to be known collectively, at the BIA's suggestion, as the Coast Indian Community. The Klamath River flooded the Rancheria, which is largely flatland, in December 1964, forcing the relocation of all but two of the families. The two remaining families moved off the land when their homes burned, one in 1969 and the other in 1973. Since the last date, no one has lived permanently on the Rancheria, but most of the Indian families formerly resident there have continued using it for camping and gardening, often staying on the land for extended periods in the summer and fall of the year.

Across the river to the north of the Rancheria is a lumber processing mill of the Simpson Timber Company (hereafter Simpson). To the south of the Rancheria lies a hilly area replete with high quality redwood and Douglas fir timber, timber mostly owned, cut, and processed by Simpson. The BIA issued an annual revocable permit to Simpson on March 26, 1965, allowing Simpson to transport approximately 4 million board feet of timber across the Rancheria. For this privilege, Simpson was charged 25 cents per thousand board feet, the fair rental value of the right-of-way as determined by BIA appraiser Elmer Heisel.

[1] 4 Fed. Reg. 4475 (1939).

Even before March 1965, however, Simpson and the BIA began discussing the acquisition by Simpson of a permanent right-of-way over the Indian land. BIA agents told Simpson that the latter should have the County apply for a permanent public road easement. The County, having obtained Simpson's agreement to pay all costs of acquiring and building the road sought, applied for and was granted this easement. Pursuant to Heisel's appraisal, the BIA sold the right-of-way now at issue to the County for $2,500 on April 5, 1966. This right-of-way running for 1,934.11 feet along the southern boundary of the Rancheria, with an average width of 50 feet and a total area of 2.06 acres, was eventually turned into a public road by virtue of improvements made by Simpson. It was accepted into the County's road system in 1972.

II.

To determine whether plaintiffs hold a compensable interest in the Rancheria, the court must decide whether the members of the Coast Indian Community were in fact the beneficial owners of the Rancheria. It is undisputed that the United States held title to the Rancheria in 1966 as trustee. However, defendant contends that, as of the date of the right-of-way sale, no individual Indian had been "designated" as the beneficiary of the trust by the Secretary of the Interior, as required by the 1938 deed and the 1939 proclamation.[2]

Dorothy Frye, a widow, testified at trial that in 1938, at the urging of an agent of the BIA, she, her husband William (now deceased), and their three children moved into a one-room shack on the Rancheria and were the first Indians to settle there. Later, when the donor of the land left, the Fryes moved into the main house. They continued

[2] Plaintiffs contend that defendant may not even raise this issue now, because defendant's failure to deny in the pleadings and pretrial statements that plaintiffs possessed a compensable interest in the Rancheria operated as an estoppel against defendant on this issue. Whether defendant may properly raise this point for the first time in its post-trial brief need not now be decided, in view of the fact that there is evidence sufficient to establish that by April 1966, plaintiffs had been "designated" the beneficial owners of the Rancheria within the meaning of the deed and proclamation.

to live on the Rancheria until the main house burned in 1969 and their daughter's house burned in 1973.

The second family arriving at the Rancheria, according to Mrs. Frye, was William Scott and his wife. With the help of William Frye, the BIA then built five houses. The Rancheria group continued to grow until 13 families lived there by 1960, some living in mobile homes they brought with them. Thereafter, the population numbered about 75 people, of which about 50 were children.

The Coast Indian Community was comprised of formerly homeless Indians living on the Rancheria. In March 1964, according to Mrs. Frye, those actually living at the Rancheria were the Dowds, the Fryes, two families named Frank, the Hoffmans, the Jakes, the Jameses, the McCoveys, the Novas, the Proctors, the Scotts, the Wards, and the Brahams. Except for a few husbands, all of these persons were Indians. Most of the husbands worked away from the Rancheria, mainly in the woods for Simpson.

In 1964, all but two houses were swept away by the Klamath River flood and the only residents thereafter were William and Dorothy Frye, their daughter Dorothy Frye Williams, and their families. Although the BIA agreed to replace the destroyed homes, they could not be built on the Rancheria site, which was determined to be flood plain. Since fires destroyed the remaining homes, the land has been used only in the summer for gardening and camping by seven or eight families, according to Mrs. Frye.

Venola Dowd testified that she moved to the Rancheria on July 4, 1940, at age 14 with her mother, Lena McCovey. She corroborated Mrs. Frye's testimony that 13 families had accepted the BIA's invitation and had taken up residence on the Rancheria before the 1964 flood. Thereafter, only two families lived on the Rancheria. The rest were resettled mainly at Crescent City, California, although three families settled across the Klamath River from the Rancheria. The testimony by Mrs. Frye and Mrs. Dowd stands uncontradicted.

While the 1938 deed and the 1939 proclamation indicate that the Secretary of the Interior would designate the beneficial owners of the Rancheria, no specific procedures for accomplishing such designation were prescribed. Hence,

it was not necessary that the designation be made by a formal proclamation, listing all the beneficiaries by name. Moreover, the personnel of the BIA, as subordinates of the Secretary specifically empowered to deal with Indian problems on his behalf,[3] could accomplish the designation.[4]

Thus, in the absence of specifically prescribed designation procedures, the conduct of the BIA in locating the Coast Indian Community members on the Rancheria, in acquiescing in their continued presence on and use of the Rancheria for many years, in building houses for them on the Rancheria, and in providing plaintiffs with services usually accorded to Indians living on a reservation,[5] provides strong and uncontroverted evidence of their designation as the Rancheria beneficiaries within the meaning of the deed and proclamation. On such evidence, designation may be inferred by law. *United States* v. *Assiniboine Tribe*, 192 Ct. Cl. 679, 690, 428 F.2d 1324, 1329–30 (1970).[6]

Accordingly, the status of plaintiffs as beneficial owners of the Rancheria, entitled to share in the profits and sale

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[3] *See* 25 U.S.C. §1a (1970); Reorganization Plan No. 3, May 24, 1950, 15 Fed. Reg. 3174 (App. to 5 U.S.C. at 530 (1970)).

[4] See regulations dealing with "unorganized" California rancherias published on August 13, 1965, at 30 Fed. Reg. 10098, now codified as 25 C.F.R. §242.1 *et seq.* (1975). These regulations recognize the existence of rancherias not governed by any organic document ("unorganized"), use and occupancy privileges thereon held by Indians without reference made in any written instrument ("informal assignment"), and the right of Indians residing on rancherias for at least 3 years to share in any distribution of rancheria assets under the California Rancheria Act (*see* note 9 of this opinion), although they did not even hold "informal assignments." 25 C.F.R. §§242.2(h), (j); 242.3(a)(4), (c); and 242.4(b). These rules indicate that a designation absent formalities, and consisting only in locating Indians on the Rancheria and providing for their needs there, was within the contemplation of the Secretary. If this were his interpretation of the deed and proclamation—that informal locating and provision of assistance suffices to identify "such Indians * * * as shall be designated by the Secretary" and amounts to such designation—no statement of greater formality could be expected. This is perfectly consistent with the Secretary's silence on the matter from 1938 through the mid-1960's, when that silence was broken only in response to duties prescribed in the Rancheria Act, whereupon he drew up a list of Rancheria voters and distributees that included plaintiffs.

[5] The authority of the BIA to provide the Indian plaintiffs with free medical care and with homes on an area officially designated as a reservation is unchallenged.

[6] While no formal order ever came from the President designating the Assiniboine as occupants of the Blackfoot Reservation, within the terms of an 1874 statute empowering him to determine additional reservation beneficiaries, yet governmental conduct and acquiescence were deemed sufficient to amount to their designation in law as such, entitling them to live on and share in the benefits of the reservation.

proceeds from the right-of-way at issue, has in fact been established.

Defendant has pointed out a notice published in the Federal Register on May 18, 1972,[7] to establish that it was not until January 21, 1967, some 9 months after the right-of-way grant, that the BIA determined those persons who had rights in the Rancheria. Defendant relies on the following language in the notice to establish that the first designation occurred in 1967:

> Notice is hereby given that at the request of all persons who were determined to hold rights, claims, or interests in the Coast Indian Community (Resighini Rancheria), Del Norte County, Calif., under a plan for distribution of assets * * * accepted January 21, 1967, said plan for distribution of assets * * * was revoked on January 2, 1972 * * *.[8]

The notice recites only that the distribution plan, drafted pursuant to the California Rancheria Act[9] was accepted by the Secretary of the Interior pursuant to that Act in January 1967.

On its face, this notice leaves ambiguous whether "all persons who were determined to hold rights, claims, or interests" were first designated as such in the notice, or were ascertained previously. The Rancheria Act, however, created a complex procedure for the adoption of distribution plans, such as that mentioned in the notice. Preceding acceptance of the distribution plan by the BIA, the following must occur (in order): a determination of the Indians entitled to vote on any subsequent distribution of reservation assets, an initial election by those persons to decide if a distribution plan is to be drawn up, the creation of the plan, and then an election by the same persons to accept the plan as drawn. Hence, it was not possible that the designation of Rancheria beneficiaries took place as late as the acceptance of the plan in January 1967.

The regulations of the Secretary appearing at 25 C.F.R. §242.3 (1975), in force beginning August 13, 1965, and

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[7] 37 Fed. Reg. 10010 (1972).

[8] *Id.*

[9] Pub. L. 85–671, Act of August 18, 1958, 72 Stat. 619, as amended by Pub. L. 88–419, Act of August 11, 1964, 78 Stat. 390.

throughout 1966, govern rancheria distribution elections pursuant to the Rancheria Act. It is clear from the regulations' language that the persons whose names appear on a voters' list created under the regulations are identical to those fully entitled to share in the property benefits of the rancheria. Section 242.3(c) expressly limits the list to the members of the "Indian tribe, band, or community * * * associated with the rancheria or reservation." Furthermore, section 242.3(a) includes in the voters' list for an "unorganized rancheria or reservation," the apparent legal status of plaintiffs' Rancheria, not only persons holding "allotments" and "formal assignments" but as well those "who reside on the rancheria or reservation pursuant to an informal assignment" and "[t]hose not in the above categories who have resided for a period of at least three consecutive years * * * on the rancheria or reservation not set aside for a designated group of Indians."

Although the trial record does not include any evidence of a formal designation of plaintiffs as Rancheria beneficiaries, in plaintiffs' post-trial legal arguments, the court's attention was directed to the publication on February 11, 18, and 25, 1966, in The Humboldt Times, a general circulation newspaper printed in Eureka, California, of a list of persons eligible to vote in an election to determine whether a distribution plan should be prepared for plaintiffs' Rancheria. This published notice, which complied with the requirements of section 242.3(d), was published well before the sale of the right-of-way and included the names of the eight individual plaintiffs in the present action.

Plaintiffs have furnished an affidavit from the publisher, attesting to the publication of the notice. This official notice, published in The Humboldt Times for three consecutive weeks, as required by the Rancheria Act and the regulations in order to prepare an asset distribution plan, constitutes a public, official act of the Government, one that is "capable of ready and accurate determination by resort to sources whose accuracy cannot be questioned." The voters' roster as published, evidencing a form of official designation of Rancheria beneficiaries, has there-

fore been accorded judicial notice by the court. FED. R. EVID. 201(b)(2); 9 J. WIGMORE, EVIDENCE §2571, at 548 (3d ed. 1940); MCCORMICK, EVIDENCE §328, at 758 (2d ed. 1972).

Consequently, the publication of a voters' list, as required by section 242.3(d), necessarily constitutes either a designation of reservation beneficiaries or the reaffirmation of a designation already made in the past. From the foregoing, it is concluded that plaintiffs, who like all Coast Indian Community members are beneficial owners of the Rancheria, hold a compensable interest in the reservation land, including the right-of-way at issue.

III.

A. *Plaintiffs' view*

On the subject of valuation, plaintiffs contend through their appraisal witness, Robert E. Kleiner, that the fair market value of the right-of-way, viewed from facts and circumstances known to a reasonably competent appraiser in 1966, is $57,000.[10] This figure consists of a $50,000 loss-of-profits estimate, plus $7,000 for severance damages. The $50,000 amount relates to right-of-way use fees lost because of the conveyance, fees that Mr. Kleiner said would have been paid to the BIA in trust for plaintiffs by logging companies, particularly Simpson, wishing to bring timber across the Rancheria.[11]

Mr. Kleiner calculated the total fee amount by determining the average annual fee paid or expected to be paid in the immediate future, and then capitalizing the annual fee figure at 10 percent. The average annual fee was determined by Mr. Kleiner through evaluation of the following factors:

(1) Estimates of the total volume of the Simpson timber stand, together with a topography and comparative transportation cost analysis, showed that roughly 20 million board feet of timber would annually be removed from the

[10] At trial, the court granted plaintiffs' motion to amend the petition relative to the amount of relief sought to conform to the valuation evidence adduced at trial, pursuant to Rule 39(b), in the amount of $57,000.

[11] The nearest timber plant was that of the Simpson Timber Company, located across the river from the Rancheria in Klamath, California.

timber area south of the Rancheria and taken to the mill north of the Indian tract for about 20 years, a quantity far in excess of the 1 million board feet per year figure estimated by the BIA.

(2) The same analysis indicated that the most economical route for this timber movement crossed the Rancheria right-of-way.

(3) The fair market value for use of rights-of-way in the vicinity by loggers in 1966 was at least 25 cents per thousand board feet per mile or fraction and, given inflationary trends, was probably higher.

(4) The northern segment of the timbering area, the part nearest the Klamath River mill, would be logged first according to prevailing industry practice, and this was in fact done, rather than the contrary as the BIA appraisal had assumed.

(5) Operations at the mill were regular and annually consumed from the timbering area considerably in excess of 1 million board feet in several years preceding the right-of-way sale.

(6) The 25-cent rate was usually supplemented in transactions in the vicinity with a reciprocity arrangement, whereby the party granting the right-of-way would be accorded a similar right to cross the grantee's property, and this element of value in this case should have been assigned a monetary amount since the plaintiffs had no desire for a reciprocal easement over Simpson's land.

The foregoing led Mr. Kleiner to conclude that the typical informed buyer, for use or investment, would have been willing to pay $50,000 for the right-of-way.[12] The $7,000 severance figure relates to the value decrease in the Rancheria, as realty used for recreational, agricultural, and temporary residential purposes, after the establishment of the right-of-way as a public road, carrying a large volume of logging traffic.

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[12] Mr. Kleiner viewed the fee agreement between the BIA and Simpson for the latter's use of the right-of-way as unrealistically low at 25 cents a timber unit. This rate, based on actual prior use, capitalized, gave a value of $42,000. However, increased timber volume could also justify a value of $100,000 at the same rate. Consequently, taking into consideration that an estimated 400 million board feet of timber would be carried over the right-of-way over a 20-year period, Mr. Kleiner determined the right-of-way's present value of $50,000.

Mr. Kleiner is an officer of and stockholder in Western Timber Services, Inc. His occupation is consulting forester, real estate appraiser, land surveyor, and logging engineer. He has registered professional credentials in these fields in California, Oregon, Nevada, and Alaska. He is a member of the Appraisal Institute (M.A.I.) and a past president of the National Association of Consulting Engineers. His formal education consisted of a B.S. (1941) and M.A. (1947) in forestry from the University of Washington College of Forestry. Also, he has completed three courses by the American Institute of Real Estate Appraisers, and has participated in continuing education seminars on appraisal, consulting forestry, logging engineering, and surveying. He has been employed by private clients, industry, state, county, and federal agencies, including the National Park Service, to appraise timber land rights-of-way, land for highway right-of-way acquisition, flood damaged property, recreational property, etc., in various western states including California. His work in the timber land area surrounding Klamath, California, in both Del Norte and Humboldt Counties, California, has extended over more than 20 years.

At trial, Mr. Kleiner's expert qualifications were conceded by defendant. Upon reviewing his testimony, the court determined that he was a good, reliable, credible, highly-qualified, and well-versed expert witness, whose opinion should be accorded great weight and whose testimony was legally and factually well-founded. His expert opinion was undiminished by cross-examination at trial.

B. *Defendant's view*

Defendant argues that the average annual fee that the right-of-way was expected to produce, viewed from the standpoint of 1966, amounts to no more than $250. This figure capitalized at 10 percent, is $2,500, which the BIA obtained from the County for the conveyance of the permanent easement.

Defendant relies on the appraisal made by BIA employee, Elmer A. Heisel, Jr., in anticipation of the conveyance. To arrive at the $250 income figure, Mr. Heisel reviewed past right-of-way rental receipts, averaging about $1,200

annually over a 2-year period according to BIA records, and then reduced this value to take into account (1) anticipated sporadic logging of the timbering area, and (2) the probability that the segments of the area nearest the mill would be reserved for future or emergency use rather than logged immediately. Accordingly, Mr. Heisel concluded that it was realistic to estimate that 1 million board feet of timber would be transported across the Rancheria right-of-way each year on the average. At 25 cents per thousand board feet (his earlier appraised right-of-way rental value), he felt a $250 yearly income could be expected. Since the right-of-way ran along the boundary of the Rancheria, Mr. Heisel said that no severance damage would be incurred.

Mr. Heisel has been a senior appraiser with the BIA since 1967 and at the time of trial was stationed at Grand Coulee, Washington. He joined the BIA in 1957 as a forester, after 6 years with a lumber company. In October 1960, he became an appraiser and was located at the BIA's Hoopa Valley station until November 1965, when he moved to Sacramento. He has a degree in forestry from the University of Montana. He is a member of the Society of American Foresters and the Society of Farm Managers and Rural Appraisers.

Mr. Heisel's appraisal education consisted of two courses in 1962 and 1966 offered by the Institute of Real Estate Appraisers. Mr. Heisel estimated the number of appraisals he has made at 30 to 40 in the years just after 1960, and 75 to 100 in more recent years, of which a maximum of 5 percent concerned rights-of-way, including some across Indian reservations, but with about half having timber as a factor.

The court has concluded that in the land appraisal field, the witness was not well qualified educationally and also was limited in appraisal experience relative to timber land and especially in dealing with rights-of-way acquisitions. According to Mr. Heisel's testimony, the facts he had available to him in reaching his determination and the time he had to develop his valuation report were limited. Hence, he was similarly handicapped in reaching a well-founded appraisal opinion by lack of time and factual

material essential to a valid, well-reasoned valuation determination. Consequently, his view that the value of plaintiffs' right-of-way as of April 5, 1966, was only $2,500 is not well founded and is entitled to little weight.[13]

Relative to just compensation value, the Supreme Court stated in *United States* v. *Virginia Electric & Power Co.*, 365 U.S. 624, 633 (1961) that:

> The guiding principle of just compensation is reimbursement to the owner for the property interest taken. "He is entitled to be put in as good a position pecuniarily as if his property had not been taken. He must be made whole but is not entitled to more." *Olson* v. *United States*, 292 U.S. 246, 255. In many cases this principle can readily be served by the ascertainment of fair market value—"what a willing buyer would pay in cash to a willing seller." *United States* v. *Miller*, 317 U.S. 369, 374. See *United States* v. *Commodities Corp.*, 339 U.S. 121, 123; *United States* v. *Cors*, 337 U.S. 325, 333. But this is not an absolute standard nor an exclusive method of valuation. See *United States* v. *Commodities Corp.*, *supra*, at 123; *United States* v. *Cors*, *supra*, at 332; *United States* v. *Miller*, *supra*, at 374–375; *United States* v. *Toronto Nav. Co.*, 338 U.S. 396.[14]

Plaintiffs' expert, Mr. Kleiner, reached his valuation conclusion in accordance with the foregoing principles properly applied to the facts of this case. Hence, his overall land valuation figure of $50,000 is appropriate and the court so finds.

C. *Severance damages*

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[13] Plaintiffs also point out that the BIA should not have approved in December 1965, Mr. Heisel's appraisal of the right-of-way value, which was made in August 1965. The reason given is that a memorandum dated October 11, 1965, signed by BIA Field Representative Andrew Lathem warned that new roads were being constructed in the interior of the timbering area and that there appeared a likelihood that the right-of-way, originally evaluated for limited timber removal, was marked for heavy logging traffic in the then near future. Plaintiffs assert that this memorandum placed the BIA on actual notice of the inadequacy of Mr. Heisel's August appraisal.

[14] *See also United States* v. *Fuller*, 409 U.S. 488, 490–91 (1973); *Almota Farmers Elevator & Warehouse Co.* v. *United States*, 409 U.S. 470, 474 (1973); *United States* v. *Chandler-Dunbar Water Power Co.*, 229 U.S. 53 (1913); *Rocca* v. *United States*, 205 Ct. Cl. 275, 280–81, 500 F.2d 492, 494–95 (1974); *Osage Nation* v. *United States*, 119 Ct. Cl. 592, 632–33, 97 F. Supp. 381, 403, *cert. denied*, 342 U.S. 896 (1951); *Rogue River Tribe* v. *United States*, 116 Ct. Cl. 454, 478, 89 F. Supp. 798, 803 (1950), *cert. denied*, 341 U.S. 902 (1951); *Iowa-Wisconsin Bridge Co.* v. *United States*, 114 Ct. Cl. 464, 497, 84 F. Supp. 852, 859 (1949), *cert. denied*, 339 U.S. 982 (1950).

Plaintiffs also seek severance damage compensation. Plaintiffs' expert, Mr. Kleiner, explained that he arrived at $7,000 for severance damages by determining the value of the remaining Rancheria land before the right-of-way was granted in April 1966, and subtracting from it the value of the remaining land of the Rancheria after the right-of-way was transferred. The difference, or reduction in fair market value, thus represented severance damages.

Land Outside of Right-of-Way

1. Before right-of-way grant	$75,000
2. After right-of-way grant	68,000
3. Reduction in value (Severance)	$ 7,000

Mr. Kleiner explained his rationale in trial testimony. He stated that the property located outside of the right-of-way was used for recreational, agricultural, and residential purposes. He estimated that the property was better suited for those purposes before the road was taken, since after the taking there were very few restrictions on trucks using the road. Except for weight, there were few restrictions on the number of trucks, the number of times the trucks could use the road, and the amount of oiling, or surface dust control required. The absence of these restrictions would reduce the value of the land for recreation, agriculture and temporary residential use.

Defendant offered no evidence to rebut this testimony and valuation, which would be indicative of a change or lack of change in the value of the remainder of the tract after the conveyance of the right-of-way.

Severance damage has been legally defined as the deterioration in value of the owner's remaining property caused by the transfer of property rights to a part of the land.[15] In this connection, the Supreme Court stated in *United States* v. *Miller*, 317 U.S. 369, 376 (1943) that:

> If only a portion of a single tract is taken, the owner's compensation for that taking includes any element of

[15] *United States* v. *121.20 Acres of Land*, 333 F.Supp. 21, 26 (E.D. N.C. 1971), in which severance compensation was awarded for the decline in value of the 80 home acres remaining after the former owner's farmland tract adjoining a forest preserve was taken by the Government to add to that preserve. *See also* 4A NICHOLS', EMINENT DOMAIN, §§14.1[3] and 14.21, at 14–31 to 14–35 and 14–49 to 14–53 (rev. 3d ed. 1975).

value arising out of the relation of the part taken to the entire tract.[16]

In the instant case, we feel there is an insufficient showing that the value of plaintiffs' remaining property was in fact sufficiently diminished by the taking of the right-of-way to support a finding of compensable severance damage. Consequently, severance value compensation is inappropriate here. For this reason, the court determines that severance damages should not be granted here.

IV.

The pivotal legal question in this case concerns the proper grounds for relief from the action of the BIA in selling the right-of-way for such a nominal amount as $2,500, which represents only about 5 percent of its true value.[17] The issue is whether the BIA's act constituted an inverse taking of property compensable under the fifth amendment, or, alternatively, a breach of the Government's fiduciary obligation as trustee for the Coast Indian Community.

A. *Taking of property*

In order for a taking to occur by virtue of the act of an agent of the Government, the agent's act must be accomplished within the scope of his statutory or delegated authority, and it must invade private property rights in such a manner and degree that compensation may fairly be said to be due under the fifth amendment. The character of the interference must of course be judged on the facts of each case, but a determination that there was an invasion requires at the minimum a showing that private property rights existed in the claimant.

1. Authority and the Indian consents

The first element in establishing a taking consists of showing that the governmental agent's act which is said to amount to an inverse condemnation was within the scope

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[16] *See also Campbell* v. *United States*, 266 U.S. 368, 369, 371 (1924).

[17] The court has found as a fact that a reasonably diligent appraisal, conducted just prior to the sale in 1966, should have produced a value figure for the right-of-way more than 20 times the amount of the BIA's appraisal. See Part III of this opinion.

of the agent's authority. Absent such a showing, there can only be a tortious trespass, for which the fifth amendment does not require compensation by the sovereign.[18] Evidence demonstrating the existence of the requisite authority in the agent must be supplied by plaintiff.[19] Appropriations of Indian lands by the acts of Government agents, which were mistaken or tortious in origin, have been held to be takings only if Congress was informed of the encroachments and ratified them, expressly or by inaction,[20] or the President, who historically possesses power over public lands, ratified the Government's acquisition of the lands, with the full knowledge and acquiescence of Congress.[21]

The facts of the instant case show neither authority in the local office of the BIA to make the right-of-way conveyance that it did, nor ratification of the conveyance by any party possessing the power to give it effect. The conveyance was approved 9 years ago at the level of the Sacramento area office of the BIA, and there is no indication in the record that the matter was called to the attention of Congress. This is not sufficient to infer a ratification by Congress, due to long-standing effect, high official approval, or actual knowledge.

It is claimed that the BIA conveyed the right-of-way pursuant to the authority vested in the Secretary of the Interior by 25 U.S.C. §323 (1970), enacted in 1948, and delegated by him to the BIA and its local agencies.[22] This is the sole authority cited in support of the conveyance, and

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[18] *United States* v. *Goltra*, 312 U.S. 203, 208–09 (1941); *Portsmouth Co.* v. *United States*, 260 U.S. 327, 330 (1922); *United States* v. *North American Transp. & Trading Co.*, 253 U.S. 330, 334 (1920); *Societe Cotonniere Du Tonkin* v. *United States*, 145 Ct. Cl. 426, 441–42, 171 F.Supp. 951, 959–60 (1959), *cert. denied*, 361 U.S. 965 (1960).

[19] *Porter* v. *United States*, 204 Ct. Cl. 355, 496 F.2d 583 (1974), *cert. denied*, 420 U.S. 1004 (1975); *Housing Corp.* v. *United States*, 199 Ct. Cl. 705, 711, 468 F.2d 922, 925 (1972).

[20] *Shoshone Tribe* v. *United States*, 299 U.S. 476, 489, 494–96 (1937), *United States* v. *Creek Nation*, 295 U.S. 103, 107, 109–11 (1935), *United States* v. *Pueblo of Taos*, 207 Ct. Cl. 53, 515 F.2d 1404 (1975), *United States* v. *Northern Paiute Nation*, 203 Ct. Cl. 468, 474–75, 490 F.2d 954, 957–58 (1974), and *Seminole Nation* v. *United States*, 102 Ct. Cl. 565, 618–20 (1944), *cert. denied*, 326 U.S. 719 (1945).

[21] *Confederated Salish & Kootenai Tribes* v. *United States*, 185 Ct. Cl. 421, 425–28, 401 F.2d 785, 787–89 (1968), *cert. denied*, 393 U.S. 1055 (1969). In this case, lapse of time was also a factor, for the Government had consistently treated the appropriated land as its own (and part of a national forest) since the late 19th century.

[22] *See* 25 C.F.R. §161.1(a) (1975).

the only one known to permit it. Section 323, it is true, conferred broad powers on the Secretary "to grant rights-of-way for all purposes" across Indian lands held in trust by the United States. But section 324 of the same title, and regulations promulgated under section 323, codified at 25 C.F.R. §§161.1 *et seq.* (1967), restricted those powers by requiring that consents of Indian occupants be obtained in certain circumstances before making a conveyance pursuant to section 323. The local BIA officials were legally bound to follow the statutory[23] and regulation-based[24] procedures in the course of executing the conveyance, and any conveyance in violation of those procedures necessarily amounted to an unauthorized, void, and wrongful act, for which the sovereign bears no responsibility under the fifth amendment.

The BIA violated the restrictions contained in the statute and regulations, for although it was required by them to obtain the consents of a majority of the adult members of the Coast Indian Community before conveying the right-of-way, it failed to do so. Section 324, as well as section 161.3(b) and (c) of the regulations in force in 1966, required that the consents of the individual Indian "owners or owner" be obtained before an exercise of authority under section 323 could take effect.[25] The only exception to the foregoing applicable in this case permitted the consents of the holders of a majority of the interests in the land concerned to stand in lieu of universal consent.[26]

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[23] The provisions of sections 323 and 324 must be read together, for they constituted the first and second sections, respectively, of the same enactment, Act of February 5, 1948, ch. 45, 62 Stat. 18.

[24] *Service* v. *Dulles*, 354 U.S. 363, 388 (1957); *Accardi* v. *Shaughnessy*, 347 U.S. 260 (1954); *Jones* v. *United States*, 203 Ct. Cl. 544, 550 (1974). Section 323 provides that conveyances are to be made pursuant to it "under such conditions as [the Secretary] may prescribe"; section 328 of the same title vests the Secretary with power to issue regulations to carry section 323 into effect.

[25] Section 324 expressly forbids the use of section 323 powers with respect to tribal lands without the consent of "the proper tribal officials." It implicitly forbids such use over other Indian lands absent consent, by limiting or dispensing with the need for consent in specified instances.

[26] Sections 324(1) and 161.3(c)(2). The provision in sections 324(4) and 161.3(c)(5) dispensing with consents altogether when the Secretary finds that the number of interest holders is in practicality too great to permit the gathering of consents clearly does not apply here, for the number of Coast Indian Community members was not so large, nor was any finding to that effect shown to have been made.

By their terms, sections 324 and 161.3(b) limit the consent requirement to situations involving lands that are "owned" by their Indian occupants. But this concept of ownership includes beneficial ownership, and it has already been established that Coast Indian Community members are beneficial owners of the Rancheria.[27] Although the language of both the statute and the regulation, which parallel each other, is ambiguous on this point, the ambiguity is resolved, in favor of the determination that beneficial ownership was intended to be within the language of the provisions in force in 1966, by a reading of a clarifying revision of the right-of-way regulations in 1968 and 1971.[28] A comparison of the regulations operative in 1966 with the later revisions reveal that the rewritten language was promulgated solely to clarify the predecessor provisions, not to alter the right-of-way grant scheme (at least as to consent requirements). In view of this clarifying objective, the subsequent effective date does not detract at all from the revisions' relevance to an interpretation of the superseded provisions.[29] The revised regulations provide that:

> * * * no right-of-way shall be granted over and across any individually owned lands, * * * without the prior written consent of the owner or owners of such lands * * *.[30]

and define "individually owned land" to include "land or any interest therein held in trust by the United States for the benefit of individual Indians."[31] Since the Rancheria falls within this description of "individually owned land,"[32]

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[27] See Part II of this opinion.

[28] 25 C.F.R. §§161.1 *et seq.* were generally revised by 33 Fed. Reg. 19803, Dec. 27, 1968, and section 161.3 was further amended by 36 Fed. Reg. 14183, July 31, 1971.

[29] *Victory Constr. Co.* v. *United States*, 206 Ct. Cl. 274, 510 F.2d 1379 (1975); *Hills Transp. Co.* v. *United States*, 204 Ct. Cl. 51, 492 F.2d 1394 (1974). *See also Bethlehem Steel Corp.* v. *United States*, 206 Ct. Cl. 122, 511 F.2d 529, *cert. denied*, 423 U.S. 840 (1975).

[30] 25 C.F.R. §161.3(b)(1975).

[31] *Id.* §161.1(b).

[32] The United States acquired the Rancheria, according to the 1938 deed and the 1939 proclamation, pursuant to section 5 of the 1934 Indian Reorganization Act, 25 U.S.C. §465 (1970). Section 465 provided that the title to land acquired under it "* * * shall be taken in the name of the United States in trust for the Indian tribe or individual Indian for which the land is acquired * * *." Section 479 of the same title, originally section 19 of the 1934 Act, defined "tribe" for the purposes of the Act

consent of the Coast Indian Community members was a prerequisite to the authority in the BIA to make the right-of-way conveyance, under a reasonable interpretation of the statute and of the regulations in force at the time of the conveyance actually made.

The Coast Indian Community members' interests in the Rancheria being undivided and equivalent, the consents of a majority of the adult members are needed to satisfy the statute and regulations.[33] An undated consent form placed in evidence stated that the signators agreed to the conveyance of a right-of-way 50 feet wide and 1,731 feet long[34] for such consideration as the BIA deemed appropriate, and was allegedly signed by William Frye (now deceased), Minnie Frank (now deceased), and Theodore Jake, who testified that the signature on the consent form was not his.[35] The evidence shows that the Coast Indian Community in April 1966 was comprised of 13 families, and so a majority vote of the adult members required responses from more than the three persons whose names appear on the supposed consent form. The consent document offered in this case—undated, unwitnessed, and a generally irregular legal document—is thus insufficient to constitute the landholders' consent required by the statute and regulations.[36]

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as "* * * any Indian tribe, organized band, pueblo, or the Indians residing on one reservation." The Coast Indian Community does not come within this definition, for it is not a tribe in the anthropological sense of the term, nor is it organized or a pueblo, nor were its members residing together on one reservation before or at the time of the Rancheria acquisition. The Rancheria, then, was not acquired for a tribe, leaving only the possibility under the Act that it was purchased for individual Indians. The deed and proclamation say nothing to contradict this. Thus, the land was taken in trust for the individual Coast Indian Community members.

[33] See note 26 of this opinion.

[34] The actual conveyance was 1,934.11 feet in length.

[35] There was also documentary evidence of still more consents, purporting to approve transfer of a roadway to the County in 1954. An all-important map identifying the road was not attached to the document, as the document indicated it was. This evidence undoubtedly relates to a public road which already ran through the eastern part of the Rancheria in 1966, with which the right-of-way at issue here connects, but which comprises no part of that right-of-way. The probative value of this consent document is negligible and this evidence has therefore been accorded no weight.

[36] It has been suggested that Frye's consent alone is adequate, since all Coast Indian Community members but two, no longer resided permanently on the Rancheria in 1966, and because Frye was the husband of one of those residents and the father of the other. This cannot be seriously considered, for no valid legal reason

The court must therefore conclude that the BIA's conveyance of the right-of-way in the absence of the required consents was an act beyond the authority of the Government agents involved. It was wrongful as to the Coast Indian Community members, and so, there being no evidence of a ratification of this wrongful act by the United States, the sovereign cannot be held liable under the fifth amendment, as no constitutional taking occurred.

2. Legal interest in the property appropriated

Another element in establishing a taking is the demonstration that the claimant possessed private property rights in the subject matter allegedly taken. The present case is distinguishable from instances in which lands possessed by Indian claimants under aboriginal title, recognized title, or fee patent were held to have been taken.[37] Here, plaintiffs did not hold legal title to the Rancheria, for they only became beneficiaries of the Rancheria's conveyance to the United States by designation of the BIA.[38]

B. *Breach of trust*

Next, we must consider whether a breach of trust by the United States occurred when the BIA sold the right-of-way for only about 5 percent of its fair market value and whether plaintiffs are entitled to recover, in damages for breach of trust, the difference between the full value of the land conveyed and the sale proceeds actually received.

That the Government owed a fiduciary duty to the members of the Coast Indian Community in the course of its management of the Rancheria can hardly be disputed. The Rancheria was held in trust by the United States for the benefit of the Coast Indian Community.[39] Section 323, under which the BIA purported to sell the right-of-way, contemplated the conveyance of rights-of-way by the

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has been offered for ignoring the beneficial interests of the nonresident Coast Indian Community members, nor has there been produced even a power of attorney or other instrument or explanation giving to Frye the right or ability to execute a consent for another adult person.

[37] *See, e.g., United States* v. *Creek Nation*, 295 U.S. 103 (1935); *Confederated Salish & Kootenai Tribes* v. *United States*, 193 Ct. Cl. 801, 437 F.2d 458 (1971); *Tlingit & Haida Indians* v. *United States*, 182 Ct. Cl. 130, 389 F.2d 778 (1968).

[38] See Part II of this opinion.

[39] 25 U.S.C. §465 (1970). *See* note 32 of this opinion.

Secretary on behalf of Indian groups as an exercise of the Government's authority as guardian or trustee over Indian property.[40] These facts, viewed in light of the decisions of the Supreme Court and of this court establishing the Government's role as a fiduciary regarding Indian property,[41] require that the actions of the Government in this case, as accomplished through its agents, the local officials of the BIA, must be judged according to the standards applicable to a trustee engaged in the management of trust property.

The United States, when acting as trustee for the property of its Indian wards, is held to the most exacting fiduciary standards.[42] These standards extend equally to the local agents of the BIA, and the responsibility of the trustee includes accountability for the acts of those agents, even where wrongful and unauthorized.

A trustee is under a duty to exercise due care and prudence to preserve the trust property. If the trustee is guilty of negligence in his dealings with that property, the trustee is liable to the beneficiary for any loss thereon.[43] Mere evidence of a disparity between the value that the trustee realized in disposing of trust property and the fair market value at the time of that disposition, as later independently appraised, is not sufficient to establish negligence or other breach on the part of the trustee. However, demonstration of fraud or gross negligence in the actual conduct of the United States as trustee, or in the conduct of its agents, will make the Government liable for

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[40] S. Rep. 823, 80th Cong., 2d Sess., 1948 U.S. CODE CONG. & AD. SERV. 1033, 1036; *Three Affiliated Tribes* v. *United States*, 182 Ct. Cl. 543, 553, 390 F.2d 686, 691 (1968); *Klamath & Modoc Tribes* v. *United States*, 193 Ct. Cl. 670, 684–85, 436 F.2d 1008, 1015, *cert. denied*, 404 U.S. 950 (1971).

[41] *Seminole Nation* v. *United States*, 316 U.S. 286, 296–97 (1942); *Navajo Tribe of Indians* v. *United States*, 176 Ct. Cl. 502, 507, 364 F.2d 320, 322 (1966); *Oneida Tribe* v. *United States*, 165 Ct. Cl. 487, 494, *cert. denied*, 379 U.S. 946 (1964); *Menominee Tribe* v. *United States*, 101 Ct. Cl. 10, 19 (1944). *See also United States* v. *Mason*, 412 U.S. 391, 398 (1973); *Cheyenne-Arapaho Tribes* v. *United States*, 206 Ct. Cl. 340, 512 F.2d 1390 (1975); *Pyramid Lake Paiute Tribe* v. *Morton*, 354 F.Supp. 252 (D. D.C. 1973); *Manchester Band of Pomo Indians* v. *United States*, 363 F.Supp. 1238 (N.D. Cal. 1973).

[42] *United States* v. *Mason*, *supra* note 41; *Seminole Nation* v. *United States*, *supra* note 41; *Ottawa Tribe* v. *United States*, 166 Ct. Cl. 373, 380, *cert. denied*, 379 U.S. 929 (1964).

[43] 2A SCOTT, TRUSTS §§174, 176 (3d ed. 1967).

damages in breach of trust growing out of the fraud or negligence.[44] Further, a showing that the value realized from the trust property was so far below its fair market value as to constitute fraudulent conduct, gross negligence, or other breach of a fiduciary duty, will suffice without more to establish the trustee's liability.[45]

The evidence in the instant case shows gross negligence on the part of the trustee's agent, the local office of the BIA, in attempting to ascertain a value for the right-of-way and causing plaintiffs to be damaged to the extent of the difference between the nominal sale price, $2,500, and the fair market value of the conveyance, $50,000. The defects in defendant's appraisal were so substantial and numerous as to make it thoroughly inadequate and incompetent. These defects include: (1) Mr. Heisel's breakline was incorrect, and far more sections of timbering area would have been harvested for removal over plaintiffs' right-of-way than the four sections that the BIA appraiser assumed; (2) the estimate of the volume to be harvested each year from the foregoing sections was incredibly low, and was so even taking only the four sections into account; (3) the appraisal ignored rising right-of-way fees in the area as well as the fact that those fees were usually coupled with reciprocal exchanges, without which the fees would reasonably have been even greater; (4) the difficulty and expense of obtaining alternate routes for timber removal was not considered; and (5) the estimated volume of timber traffic was at extreme variance with immediate past and present figures on such at the time the appraisal was made.

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[44] *Creek Nation* v. *United States*, 97 Ct. Cl. 602 (1942), *cert. denied*, 318 U.S. 787 (1943); *Seminole Nation* v. *United States*, 92 Ct. Cl. 210 (1940), *cert. denied*, 313 U.S. 563 (1941).

[45] *Klamath & Modoc Tribes* v. *United States*, *supra* note 40, 193 Ct. Cl. at 684–86, 436 F.2d at 1015; *Three Affiliated Tribes* v. *United States*, *supra* note 40, 182 Ct. Cl. at 551, 390 F.2d at 690. This court's observation in cited cases that very great disparity between the market value and the sale price on conversion of an asset to cash in itself evidences breach of trust was made with reference to the Indian Claims Commission Act. However, this court cited as the basis for that proposition two cases which predated that Act, *Creek Nation* v. *United States*, *supra* note 44, and *Seminole Nation* v. *United States*, *supra* note 44. Hence, it is concluded, at least under the facts of this case, that the Act is not necessary to a finding of liability for breach of trust based solely on the incredible size of the disparity between the BIA's price and the actual market value.

Plaintiffs' expert accurately characterized the BIA valuation as deficient on these grounds, and Mr. Heisel, called as the Government's expert, failed to support his appraisal against this attack. Further, it is of no comfort to the Government's case that a memorandum signed by one of the BIA's own field representatives, Andrew Lathem, disclosed to the Sacramento area office an anticipated volume of timbering south of the Rancheria at great variance with the assumptions of the appraisal finally relied upon. The memorandum, received by the BIA after Mr. Heisel conducted his appraisal but before the latter was approved as the basis for the right-of-way sale, noted the increased road construction activity in the interior of the timbering area, evidencing expectation of greater harvesting of the area in the near future.

This court in *Chippewa Indians of Minnesota* v. *United States*, 91 Ct. Cl. 97 (1940), allowed recovery under similar circumstances for a detrimentally incompetent appraisal, although the value-price disparity was not as aggravated as in the present case. There, the Secretary of the Interior appointed 35 appraisers to make a valuation study of the Chippewa's land, which was being conveyed to the United States under a treaty and act of Congress for later sale by the Government to the account of the Indians. Twenty-five of these appraisers were plainly unqualified, and the skilled foreman was not even allowed to review their work. Since this appraisal resulted in a realization of only 50 percent of the actual value of the land sold, recovery was given in the amount of the deficiency. A statute was of course involved, which set the high standard of care to be exercised in the appointment of, and in the work by, the appraisers. However, a recovery is equally in order for a detrimentally incompetent appraisal where a standard of care is present similar to that set in the statute in *Chippewa*. That is the case here, in view of the exacting fiduciary standards to which the Government must be held.

The evidence also shows a differential of 2,000 percent between the actual value and the price received, a disparity that on its face strains the normal legal concepts of fiduciary responsibility, even when considered most favora-

bly to the trustee. This is the clearest possible case of value received:

> * * * so far below the then fair market value * * * as to amount to * * * gross negligence, or some other breach of its fiduciary obligations on the part of the Government.[46]

The 2,000 percent differential is far indeed from a "mere disparity."[47]

Accordingly, plaintiffs are entitled to recover for the Government's negligent conduct in the valuation of the right-of-way for sale to the County, as evidenced by the gross inadequacy and incompetence of the appraisal employed by the BIA, and by the very wide disparity between market value and price.[48] The United States failed to act here in a manner that met the high fiduciary standards imposed upon it when it deals with Indian property as a trustee. It must therefore respond in damages for breach of its trust obligations, in an amount equal to the full market value that should have been realized upon the right-of-way sale, less the sum actually paid to the BIA for the conveyance.

V.

Plaintiffs seek interest from the date of the right-of-way sale to the date of payment of judgment in this litigation. First, they contend that back interest is always given on a taking, citing note 23 in *Klamath & Modoc Tribes* v. *United*

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[46] *Three Affiliated Tribes* v. *United States, supra* note 45.

[47] *Id. See Nez Perce Tribe* v. *United States*, 176 Ct. Cl. 815 (1966), *cert. denied*, 386 U.S. 984, 1015 (1967), in which a disparity of 33-1/3 percent was found to be a violation of "fair and honorable dealings" under the Indian Claims Commission Act. Similar violations were found under that Act in *Sac & Fox Tribe* v. *United States*, 167 Ct. Cl. 710, 340 F.2d 368 (1964), for a disparity between a $1.24 payment and a $3 value per acre, and in *Miami Tribe* v. *United States*, 150 Ct. Cl. 725, 281 F.2d 202 (1960), *cert. denied*, 366 U.S. 924 (1961), for the realization of only 38 percent of the property's market value.

[48] In *United States* v. *Pueblo of Taos, supra* note 20, this court indicated that recovery in a valuation dispute must be predicated upon, not simple opinion differences or mere disparities, but on definite proof that a breach of trust has occurred. The imposition of a very high standard of care in fulfilling a certain duty, whether prescribed by statute or precedent, may well affect the point at which breach is determined to exist, but it cannot in itself alter the test for breach where land value is the prime issue.

States, 193 Ct. Cl. 670, 686, 436 F.2d 1008, 1015-16, *cert. denied*, 404 U.S. 950 (1971). Alternatively, plaintiffs contend that they are equally entitled to interest if liability is based on a breach of trust, citing G. BOGERT, HANDBOOK OF THE LAW OF TRUSTS at 608 (3d ed. 1952), in which it is said that the damage measure for breach of trust is the difference between the trust capital and income accounts as they would have existed if the trust were performed and as they do exist on account of the breach.

It is true that 4 percent simple interest is usually awarded from the date of taking as part of the just compensation award required by the Constitution, where a determination of a taking is made. However, it is well established that interest from the date that the claim arises until date of judgment is not awarded as part of a recovery for breach of trust. *United States* v. *Mescalero Apache Tribe*, 207 Ct. Cl. 369, 518 F.2d 1309 (1975) *cert. denied*, 425 U.S. 911 (1976); *Klamath & Modoc Tribes* v. *United States*, *supra*; *Three Affiliated Tribes* v. *United States*, 182 Ct. Cl. 543, 390 F.2d 686 (1968); and *Confederated Salish & Kootenai Tribes* v. *United States*, 175 Ct. Cl. 451, *cert. denied*, 385 U.S. 921 (1966). The only exception to this rule is that prescribed by statute or express agreement. There is no agreement to this effect in this case. *See United States* v. *Mescalero Apache Tribe*, *supra*; *Chippewa Indians* v. *United States* 91 Ct. Cl. 97 (1940). Relative to a statutory exception, since 1929 25 U.S.C. §§161 and 161a (1970) have prescribed payment of 4 percent simple interest on proceeds of the sale of Indian trust lands on deposit in the United States Treasury, and these provisions have been the basis for recovery of interest on judgments in this court, when yet other statutes do not impair their effect.[49] Further, when funds do exist in the hands of the Government as trustee for the Indians, the provisions have been interpreted as a floor for yield on investments.[50]

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[49] *See Confederated Salish & Kootenai Tribes* v. *United States*, 186 Ct. Cl. 947 (1968); *Confederated Salish & Kootenai Tribes* v. *United States*, 175 Ct. Cl. at 456–57.

[50] *Cheyenne-Arapaho Tribes of Oklahoma* v. *United States*, *supra* note 41, 206 Ct. Cl. at 347–48, 512 F.2d at 1393–94; *Manchester Band of Pomo Indians* v. *United States*, *supra* note 41, 363 F.Supp. at 1243–44.

At the present time, there is nothing in the record to indicate the disposition of the $2,500 actually received in payment for the right-of-way, or the status of any other funds of the Coast Indian Community. If the payment received was held in the U.S. Treasury in a trust account for Coast Indian Community members, or if it can be shown that part of a larger realized amount would have been so held, it may be that interest should be awarded under sections 161 and 161a. However 25 C.F.R. §161.14 (1975) (25 C.F.R. §161.15 (1967)) instructs that the proceeds of a right-of-way sale are to be disbursed to or for the account of the Indian beneficiaries. This interposes the possibility that Coast Indian Community members received ratable shares of the sale proceeds immediately, that the proceeds were held in trust accounts, or that some other disposition of the proceeds was made by the BIA "to or for the account of" the members.

Therefore, further proceedings under Rule 131(c)(2) are appropriate, and the amount of the recovery will be determined accordingly.

FINDINGS OF FACT

1. Plaintiffs are members of an unincorporated association known as the Coast Indian Community. They seek damages from the United States in the amount of $54,500, plus interest from April 5, 1966, for an undercompensated taking of their property and a breach of fiduciary obligation owed plaintiffs by the Bureau of Indian Affairs (hereafter BIA), as an agent of the United States. As the basis for their claim, plaintiffs assert that a right-of-way across their reservation, valuable because it provided the most direct access to a large redwood and Douglas fir timbering area, was conveyed by the United States as trustee for the reservation land to the County of Del Norte, California (hereafter the County), for a grossly inadequate consideration. According to plaintiffs, the right-of-way, worth approximately $57,000, was sold by the BIA agents for $2,500. [At trial, the court granted plaintiffs' motion to amend the petition relative to the amount of relief sought

to conform to the valuation evidence adduced at trial, pursuant to Rule 39(b), in the amount of $57,000.]

2. By deed dated January 7, 1938, a tract of land known as the Rancheria was conveyed to the United States by the owner, Gus Resighini:

> * * * in Trust for such Indians of Del Norte and Humboldt Counties, in California, eligible to participate in the benefits of the [Indian Reorganization] Act of June 18, 1934 (48 Stat. 984) [25 U.S.C. §§461 *et seq.* (1970)], as shall be designated by the Secretary of the Interior * * *.

The legal description of said parcel of land, consisting of approximately 228 acres, is as follows:

> N 1/2 SW 1/4 Sec. 13, S 1/2 SE 1/4, NE 1/4 SE 1/4, S 1/2 NW 1/4 SE 1/4, SE 1/4 SW 1/4 and Lot 6, Sec. 14, N 1/2 NE 1/4 NW 1/4 Sec. 23; all in T. 13 N., R.1 E., Humboldt Meridian, in Del Norte County, California, excepting therefrom that portion thereof containing 78.42 acres conveyed to John E. McCreary by deed recorded in Book X of Deeds, page 217, Del Norte County Records.

This site, situated along the south bank of the Klamath River in the County about 3 miles from the Pacific Ocean, was purchased by the BIA under the authority of the cited statute, proclaimed an Indian reservation by the Acting Secretary of the Interior on October 21, 1939 [4 Fed. Reg. 4475 (1939)], and became known as the Resighini Rancheria. Beginning in 1938, at the invitation of an agent of the BIA, certain Indian families of Del Norte and Humboldt Counties took up residence on the Rancheria. Some 13 Indian families of various tribal origins lived there and came to be known collectively, at the BIA's suggestion, as the Coast Indian Community. The Klamath River flooded the Rancheria, which is largely flatland, in December 1964, forcing the relocation of all but two of the families. The two remaining families moved off the land when their homes burned, one in 1969 and the other in 1973. Since the last date, no one has lived permanently on the Rancheria, but most of the Indian families formerly resident there have continued using it for camping and

gardening, often staying on the land for extended periods in the summer and fall of the year.

3. Across the river to the north of the Rancheria is a lumber processing mill of the Simpson Timber Company (hereafter Simpson). To the south of the Rancheria lies a hilly area with high quality redwood and Douglas fir timber, timber mostly owned, cut, and processed by Simpson. The BIA issued an annual revocable permit to Simpson on March 26, 1965, allowing Simpson to transport approximately 4 million board feet of timber across the Rancheria. For this privilege, Simpson was charged 25 cents per thousand board feet, the fair rental value of the right-of-way as determined by BIA appraiser, Elmer Heisel.

4. Even before March 1965, however, Simpson and the BIA began discussing the acquisition by Simpson of a permanent right-of-way over the Indian land. BIA agents told Simpson that the latter should have the County apply for a permanent public road easement. The County, having obtained Simpson's agreement to pay all costs of acquiring and building the road sought, applied for and was granted this easement. Pursuant to Mr. Heisel's appraisal, the BIA sold the right-of-way now at issue to the County for $2,500 on April 5, 1966. This right-of-way running for 1,934.11 feet along the southern boundary of the Rancheria, with an average width of 50 feet and a total area of 2.06 acres, was eventually turned into a public road by virtue of improvements made by Simpson. It was accepted into the County's road system in 1972.

5. It is undisputed that the United States held title to the Rancheria in 1966 as trustee. However, defendant contends that, as of the date of the right-of-way sale, no individual Indian had been "designated" as the beneficiary of the trust by the Secretary of the Interior, as required by the 1938 deed and the 1939 proclamation. Plaintiffs contend that defendant may not even raise this issue now, because defendant's failure to deny in the pleadings and pretrial statements that plaintiffs possessed a compensable interest in the Rancheria operated as an estoppel against defendant on this issue. Whether defendant may properly raise this point for the first time in its post-trial brief need not now be decided, in view of the fact that there is

evidence sufficient to establish that by April 1966, plaintiffs had been "designated" the beneficial owners of the Rancheria within the meaning of the deed and proclamation.

6. (a) Dorothy Frye, a widow and an honest, straightforward, and credible witness, testified at trial that in 1938, at the urging of an agent of the BIA, she, her husband William (now deceased), and their three children moved into a one-room shack on the Rancheria and were the first Indians to settle there. Later, when the donor of the land left, the Fryes moved into the main house. They continued to live on the Rancheria until the main house burned in 1969 and their daughter's house burned in 1973. The second family arriving at the Rancheria, according to Mrs. Frye, was William Scott and his wife. With the help of William Frye, the BIA then built five houses. The Rancheria group continued to grow until 13 families lived there by 1960, some living in mobile homes they brought with them. Thereafter, the population numbered about 75 people, of which approximately 50 were children.

The Coast Indian Community was comprised of formerly homeless Indians living on the Rancheria. In March 1964, according to Mrs. Frye, those actually living at the Rancheria were the following:

1. Minnie Frank and spouse
2. Lena McCovey and spouse
3. Delores and Lou Nova
4. Bill Ward and spouse
5. Dixie and Kenneth Frank
6. William Scott and spouse
7. Della Braham and spouse
8. Dorothy and William Frye
9. Venola (McCovey) and Frank Dowd
10. Walter and Eveline Hoffman
11. Jeanette Proctor and spouse
12. Ollie James and spouse
13. Stella and Theodore Jake

Except for a few husbands, all the enumerated persons were Indians. Most of the husbands worked away from the Rancheria, mainly in the woods for Simpson.

In 1964, all but two houses were swept away by the Klamath River flood and the only residents thereafter were

William and Dorothy Frye, their daughter Dorothy Frye Williams, and their families. Although the BIA agreed to replace the destroyed homes, they could not be built on the Rancheria site, which was determined to be flood plain. Since fires destroyed the remaining homes, the land has been used only in the summer for gardening and camping by seven or eight families, according to Mrs. Frye.

(b) Venola Dowd, a candid and believable witness, testified that she moved to the Rancheria on July 4, 1940 at age 14 with her mother, Lena McCovey. She corroborated Mrs. Frye's testimony that 13 families had accepted the BIA's invitation and had taken up residence on the Rancheria before the 1964 flood. Thereafter, only two families lived on the Rancheria. The rest were resettled mainly at Crescent City, California, although three families settled across the Klamath River from the Rancheria.

(c) The testimony by Mrs. Frye and Mrs. Dowd stand uncontradicted.

7. While the 1938 deed and the 1939 proclamation indicate that the Secretary of the Interior would designate the beneficial owners of the Rancheria, no specific procedure for accomplishing such designation was prescribed. It was not necessary that the designation be made by a formal proclamation, listing all the beneficiaries by name. The personnel of the BIA, as subordinates of the Secretary specifically empowered to deal with Indian problems on his behalf, could accomplish the designation. *See* 25 U.S.C. § 1a (1970); Reorganization Plan No. 3, May 24, 1950, 15 Fed. Reg. 3174 (App. to 5 U.S.C. at 530 (1970)). *See also* regulations dealing with "unorganized" California rancherias on August 13, 1965, at 30 Fed. Reg. 10098, now codified as 25 C.F.R. §242.1 *et seq.* (1975). These regulations recognize the existence of rancherias not governed by any organic document ("unorganized"), use and occupancy privileges thereon held by Indians without reference made in any written instrument ("informal assignment"), and the right of Indians residing on rancherias for at least 3 years to share in any distribution of rancheria assets under the California Rancheria Act (*see* note 9 of this opinion), although they did not even hold "informal assignments." 25 C.F.R. §§242.2(h), (j); 242.3(a)(4), (c); and 242.4(b). These

rules indicate that a designation, absent formalities, and consisting only in locating Indians on the Rancheria and providing for their needs there, was within the contemplation of the Secretary. If this was his interpretation of the deed and proclamation—that informal locating and provision of assistance suffices to identify "such Indians * * * as shall be designated by the Secretary" and amounts to such designation—no statement of greater formality could be expected. This is perfectly consistent with the Secretary's silence on the matter from 1938 through the mid-1960's, when that silence was broken only in response to duties prescribed in the Rancheria Act, whereupon he drew up a list of Rancheria voters, and distributees that included plaintiffs.

8. In the absence of specifically prescribed designation procedures, the conduct of the BIA in locating the Coast Indian Community members on the Rancheria, in acquiescing in their continued presence on and use of the Rancheria for many years, in building houses for them on the Rancheria (indeed the authority of the BIA to provide the Indian plaintiffs with homes on an area officially designated as a reservation is unchallenged), and in providing plaintiffs with services usually accorded to Indians living on a reservation, provides strong and uncontroverted evidence of their designation as the Rancheria beneficiaries within the meaning of the deed and proclamation. On such evidence, designation may be implied by law. The status of plaintiffs as beneficial owners of the Rancheria, entitled to share in the profits and sale proceeds from the right-of-way at issue, has in fact been established.

9. Defendant has pointed out a notice published in the Federal Register on May 18, 1972 [37 Fed. Reg. 10010 (1972)] to establish that it was not until January 21, 1967, some 9 months after the right-of-way grant, that the BIA determined those persons who had rights in the Rancheria. Defendant relies on the following language in the notice to establish that the first designation occurred in 1967:

> Notice is hereby given that at the request of all persons who were determined to hold rights, claims, or interests in the Coast Indian Community (Resighini

Rancheria), Del Norte County, Calif., under a plan for distribution of assets * * * accepted January 21, 1967, said plan for distribution of assets * * * was revoked on January 2, 1972 * * *.

The notice recites only that the distribution plan, drafted pursuant to the California Rancheria Act [Pub. L. 85–671, Act of August 18, 1958, 72 Stat. 619, as amended by Pub. L. 88–419, Act of August 11, 1964, 78 Stat. 390.] was accepted by the Secretary of the Interior pursuant to that Act in January 1967.

This notice on its face leaves ambiguous whether "all persons who were determined to hold rights, claims, or interests" were first designated as such in the notice, or were ascertained previously. The Rancheria Act, however, created a complex procedure for the adoption of distribution plans, such as that mentioned in the notice. Preceding acceptance of the distribution plan by the BIA, the following must occur (in order): a determination of the Indians entitled to vote on any subsequent distribution of reservation assets, an initial election by those persons to decide if a distribution plan is to be drawn up, the creation of the plan, and then an election by the same persons to accept the plan as drawn. Hence, it was not possible that the designation of Rancheria beneficiaries took place as late as the acceptance of the plan in January 1967.

The regulations of the Secretary appearing at 25 C.F.R. §242.3 (1975), in force beginning August 13, 1965 and throughout 1966, govern rancheria distribution elections pursuant to the Rancheria Act. The clear language of the regulations indicate that the persons whose names appear on a voters' list created under the regulations are identical to those fully entitled to share in the property benefits of the rancheria. Section 242.3(c) expressly limits the list to the members of the "Indian tribe, band, or community * * * associated with the rancheria or reservation." Section 242.3(a) also includes in the voters' list for an "unorganized rancheria or reservation," the apparent legal status of plaintiffs' Rancheria, not only persons holding "allotments" and "formal assignments" but as well those "who reside on the rancheria or reservation pursuant to an informal assignment" and "[t]hose not in the above

categories who have resided for a period of at least three consecutive years * * * on the rancheria or reservation not set aside for a designated group of Indians."

10. On February 11, 18, and 25, 1966, The Humboldt Times, a general circulation newspaper printed in Eureka, California, published a list of persons eligible to vote in an election to determine whether a distribution plan should be prepared for plaintiffs' Rancheria. This published notice, which complied with the requirements of section 242.3(d), was published well before the sale of the right-of-way and included the names of the eight individual plaintiffs in the present action.

Plaintiffs have furnished an affidavit from the publisher, attesting to the publication of the notice. This official notice, published in The Humboldt Times for three consecutive weeks, as required by the Rancheria Act and the regulations in order to prepare an asset distribution plan, constitutes a public, official act of the Government, one that is "capable of ready and accurate determination by resort to sources whose accuracy cannot be questioned." The voters' roster as published, evidencing a form of official designation of Rancheria beneficiaries, has therefore been accorded judicial notice by the court. FED. R. EVID. 201(b)(2); 9 J. WIGMORE, EVIDENCE §2751, at 548 (3d ed. 1940); MCCORMICK, EVIDENCE §328, at 758 (2d ed. 1972).

The publication of a voters' list, as required by section 242.3(d), necessarily constitutes either a designation of reservation beneficiaries or the reaffirmation of a designation already made in the past. From the foregoing, it is concluded that plaintiffs, who like all Coast Indian Community members are beneficial owners of the Rancheria, hold a compensable interest in the reservation land, including the right-of-way at issue.

11. On the subject of valuation, plaintiffs contend through their appraisal witness, Robert E. Kleiner, that the fair market value of the right-of-way, viewed from facts and circumstances known to a reasonably competent appraiser in 1966, is $57,000. This figure consists of a $50,000 loss-of-profits estimate, plus $7,000 for severance damages. The $50,000 amount relates to right-of-way use fees lost because of the conveyance, fees that Mr. Kleiner

said would have been paid to the BIA in trust for plaintiffs by logging companies, particularly Simpson, wishing to bring timber across the Rancheria. The nearest timber plant was that of the Simpson Timber Company, located across the river from the Rancheria in Klamath, California.

12. Mr. Kleiner calculated the total fee amount by determining the average annual fee paid or expected to be paid in the immediate future, and then capitalizing the annual fee figure at 10 percent. The average annual fee was determined by Mr. Kleiner through evaluation of the following factors:

(a) Estimates of the total volume of the Simpson timber stand, together with a topography and comparative transportation cost analysis, showed that roughly 20 million board feet of timber would annually be removed from the timber area south of the Rancheria and taken to the mill north of the Indian tract for about 20 years, a quantity far in excess of the 1 million board feet per year figure estimated by the BIA.

(b) The same analysis indicated that the most economical route for this timber movement crossed the Rancheria right-of-way.

(c) The fair market value for use of rights-of-way in the vicinity by loggers in 1966 was at least 25 cents per thousand board feet per mile or fraction, and given inflationary trends was probably higher.

(d) The northern segment of the timbering area, the part nearest the Klamath River mill, would be logged first according to prevailing industry practice, and this was in fact done, rather than the contrary as the BIA appraisal had assumed.

(e) Operations at the mill were regular and annually consumed from the timbering area considerably in excess of 1 million board feet in several years preceding the right-of-way sale.

(f) The 25-cent rate was usually supplemented in transactions in the vicinity with a reciprocity arrangement, whereby the party granting the right-of-way would be accorded a similar right to cross the grantee's property, and this element of value in this case should have been

assigned a monetary amount since the plaintiffs had no desire for a reciprocal easement over Simpson's land.

These factors led Mr. Kleiner to conclude that the typical informed buyer, for use or investment, would have been willing to pay $50,000 for the right-of-way. The $7,000 severance figure relates to the value decrease in the Rancheria, as realty used for recreational, agricultural, and temporary residential purposes, after the establishment of the right-of-way as a public road, carrying a large volume of logging traffic.

Mr. Kleiner viewed the fee agreement between the BIA and Simpson for the latter's use of the right-of-way as unrealistically low at 25 cents a timber unit. This rate, based on actual prior use, capitalized, gave a value of $42,000. However, increased timber volume could also justify a value of $100,000 at the same rate. Consequently, taking into consideration that an estimated 400 million board feet of timber would be carried over the right-of-way over a 20-year period, Mr. Kleiner determined the right-of-way's present value of $50,000.

13. Mr. Kleiner is an officer of and stockholder in Western Timber Services, Inc. His occupation is consulting forester, real estate appraiser, land surveyor, and logging engineer. He has registered professional credentials in these fields in California, Oregon, Nevada, and Alaska. He is a member of the Appraisal Institute (M.A.I.) and a past president of the National Association of Consulting Engineers. His formal education consisted of a B.S. (1941) and M.A. (1947) in forestry from the University of Washington College of Forestry. He has completed three courses by the American Institute of Real Estate Appraisers, and has participated in continuing education seminars on appraisal, consulting forestry, logging engineering, and surveying. He has been employed by private clients, industry, state, county, and federal agencies, including the National Park Service, to appraise timberland rights-of-way, land for highway right-of-way acquisition, flood damaged property, recreational property, etc., in various western states including California. His work in the timberland area surrounding Klamath, California, in both Del Norte and

Humboldt Counties, California, has extended over more than 20 years.

At trial, Mr. Kleiner's expert qualifications were conceded by defendant. The Court has determined that he was a good, reliable, credible, highly qualified, and well versed expert witness, whose opinion should be accorded great weight and whose testimony was legally and factually well-founded. His expert opinion was undiminished by cross-examination at trial.

14. Defendant's view is that the average annual fee that the right-of-way was expected to produce, as of 1966, amounts to no more than $250. This figure capitalized at 10 percent, is $2,500, which the BIA obtained from the County for the conveyance of the permanent easement.

Defendant relied on the appraisal made by BIA employee, Elmer A. Heisel, Jr., in anticipation of the conveyance. To arrive at the $250 income figure, Mr. Heisel reviewed past right-of-way rental receipts, averaging about $1,200 annually over a 2-year period according to BIA records, and then reduced this value to take into account (1) anticipated sporadic logging of the timbering area, and (2) the probability that the segments of the area nearest the mill would be reserved for future or emergency use rather than logged immediately. Mr. Heisel concluded that it was realistic to estimate that 1 million board feet of timber would be transported across the Rancheria right-of-way each year on the average. At 25 cents per thousand board feet (his earlier appraised right-of-way rental value), he felt a $250 yearly income could be expected. Since the right-of-way ran along the boundary of the Rancheria, Mr. Heisel said that no severance damage would be incurred.

15. Mr. Heisel has been a senior appraiser with the BIA since 1967 and at the time of trial was stationed at Grand Coulee, Washington. He joined the BIA in 1957 as a forester, after 6 years with a lumber company. In October 1960, he became an appraiser and was located at the BIA's Hoopa Valley station until November 1965, when he moved to Sacramento. He has a degree in forestry from the University of Montana. He is a member of the Society of American Foresters and the Society of Farm Managers and Rural Appraisers. Mr. Heisel's appraisal education con-

sisted of two courses in 1962 and 1966 offered by the Institute of Real Estate Appraisers. Mr. Heisel estimated the number of appraisals he has made at 30 to 40 in the years just after 1960 and 75 to 100 in more recent years, of which a maximum of 5 percent concerned rights-of-way, including some across Indian reservations, but with about half having timber as a factor.

In the land appraisal field, the witness was not well qualified educationally and also was limited in appraisal experience relative to timberland and especially in dealing with rights-of-way acquisitions. According to Mr. Heisel's testimony, the facts he had available to him in reaching his determination and the time he had to develop his valuation report were limited. He was similarly handicapped in reaching a well-founded appraisal opinion by lack of time and factual material essential to a valid, well-reasoned valuation determination. His view that the value of plaintiffs' right-of-way as of April 5, 1966, was only $2,500 is not well founded and is entitled to little weight.

Additionally, the BIA should not have approved in December 1965, Mr. Heisel's appraisal of the right-of-way value, which was made in August 1965, for a memorandum dated October 11, 1965, signed by BIA Field Representative Andrew Lathem, warned that new roads were being constructed in the interior of the timbering area and that there appeared a likelihood that the right-of-way, originally evaluated for limited timber removal, was marked for heavy logging traffic in the then near future. This memorandum placed the BIA on actual notice of the inadequacy of Mr. Heisel's August appraisal.

16. Plaintiffs' expert, Mr. Kleiner, explained that he arrived at $7,000 for severance damages by determining the value of the remaining Rancheria land before the right-of-way was granted in April 1966 and subtracting from it the value of the remaining land of the Rancheria after the right-of-way was transferred. The difference, or reduction in fair market value, thus represented severance damages.

Land Outside of Right-of-Way

1. Before right-of-way grant	$75,000
2. After right-of-way grant	68,000
3. Reduction in value (Severance)	$7,000

Mr. Kleiner explained his rationale as follows: He stated that the property located outside of the right-of-way was used for recreational, agricultural, and residential purposes. He estimated that the property was better suited for those purposes before the road was taken, since after the taking there were very few restrictions on trucks using the road. Except for weight, there were few restrictions on the number of trucks, the number of times the trucks could use the road, and the amount of oiling, or surface dust control required. The absence of these restrictions would reduce the value of the land for recreation, agriculture and temporary residential use.

Although defendant offered no evidence to rebut this testimony and valuation, which would be indicative of a change or lack of change in the value of the remainder of the tract after the conveyance of the right-of-way, there is an insufficient showing that the value of plaintiffs' remaining property was in fact sufficiently diminished by the taking of the right-of-way to support a finding of compensable severance damage.

17. The record reveals that the local office of the BIA had no authority to make a right-of-way conveyance and that there was no ratification of the conveyance by any party possessing the power to give it effect. The conveyance was approved 9 years ago at the level of the Sacramento area office of the BIA. There is no indication in the record that the matter was ever called to the attention of Congress and a ratification by Congress cannot be inferred, due to long-standing effect, high official approval, or actual knowledge.

18. Defendant asserted that the BIA conveyed the right-of-way pursuant to the authority vested in the Secretary of the Interior by 25 U.S.C. §323 (1970), enacted in 1948, and delegated by him to the BIA and its local agencies. [*See* 25 C.F.R. §161.1(a)(1975).] While section 323 conferred broad powers to the Secretary "to grant rights-of-way for all purposes" across Indian lands held in trust by the United States, section 324 of the same title, and regulations promulgated under section 323 [codified at 25 C.F.R. §§161.1 *et seq.* (1967)] restricted those powers by requiring

that consents of Indian occupants be obtained in certain circumstances before making a conveyance pursuant to section 323. The provisions of sections 323 and 324 must be read together, for they constituted the first and second sections, respectively, of the same enactment, Act of February 5, 1948, ch. 45, 62 Stat. 18. Section 323 provides that conveyances are to be made pursuant to it "under such conditions as [the Secretary] may prescribe"; section 328 of the same title vests the Secretary with power to issue regulations to carry section 323 into effect.

19. The local BIA officials were legally bound to follow the statutory and regulation-based procedures in the course of executing a conveyance, and any conveyance in violation of those procedures necessarily amounted to an unauthorized, void, and wrongful act, for which the sovereign bears no responsibility under the fifth amendment. The BIA violated the restrictions contained in the statute and regulations, for although it was required by them to obtain the consents of a majority of the adult members of the Coast Indian Community before conveying the right-of-way, it failed to do so. Section 324, as well as section 161.3(b) and (c) of the regulations in force in 1966 required that the consents of the individual Indian "owners or owner" be obtained before an exercise of authority under section 323 could take effect. Section 324 expressly forbids the use of section 323 powers with respect to tribal lands without the consent of "the proper tribal officials." It implicitly forbids such use over other Indian lands absent consents, by limiting or dispensing with the need for consent in specified instances.

The only exception to the foregoing applicable in this case permitted the consents of the holders of a majority of the interests in the land concerned to stand in lieu of universal consent. Sections 324(1) and 161.3(c)(2). The provision in sections 324(4) and 161.3(c)(5) dispensing with consents altogether when the Secretary finds that the number of interest holders is in practicality too great to permit the gathering of consents clearly does not apply here, for the number of Coast Indian Community members

was not so large, nor was any finding to that effect shown to have been made.

By their terms, sections 324 and 161.3(b) limit the consent requirement to situations involving lands that are "owned" by their Indian occupants. But this concept of ownership includes beneficial ownership, and it has already been established that Coast Indian Community members are beneficial owners of the Rancheria. Although the language of both the statute and the regulation, which parallel each other, is ambiguous on this point, the ambiguity is resolved, in favor of the determination that beneficial ownership was intended to be within the language of the provisions in force in 1966, by a reading of a clarifying revision of the right-of-way regulations in 1968 and 1971. [25 C.F.R. §§161.1 *et seq.*, were generally revised by 33 Fed. Reg. 19803, Dec. 27, 1968, and section 161.3 was further amended by 36 Fed. Reg. 14183, July 31, 1971.]

20. The United States acquired the Rancheria, according to the 1938 deed and the 1939 proclamation, pursuant to section 5 of the 1934 Indian Reorganization Act, 25 U.S.C. §465 (1970). Section 465 provided that the title to land acquired under it "* * * shall be taken in the name of the United States in trust for the Indian tribe or individual Indian for which the land is acquired * * *." Section 479 of the same title, originally section 19 of the 1934 Act, defined "tribe" for the purposes of the Act as "* * * any Indian tribe, organized band, pueblo, or the Indians residing on one reservation." The Coast Indian Community does not come within this definition, for it is not a tribe in the anthropological sense of the term, nor is it organized or a pueblo, nor were its members residing together on one reservation before or at the time of the Rancheria acquisition. The Rancheria, then, was not acquired for a tribe, leaving only the possibility under the Act that it was purchased for individual Indians. The deed and proclamation say nothing to contradict this. Thus, the land was taken in trust for the individual Coast Indian Community members and the numbers were the beneficial owners of the Rancheria.

Since the Rancheria falls within the description of "individually owned land" in 25 C.F.R. §161.1(b) (1975),

consents of the Coast Indian Community members was a prerequisite to the authority in the BIA to make the right-of-way conveyances, under a reasonable interpretation of the statute and of the regulations in force at the time of the conveyance actually made. The Coast Indian Community members' interests in the Rancheria being undivided and equivalent, the consents of a majority of the adult members are needed to satisfy the statute and regulations.

21. An undated consent form stated that the signators agreed to the conveyance of a right-of-way 50 feet wide and 1,731 feet long [the actual conveyance was 1,934.11 feet in length] for such consideration as the BIA deemed appropriate, and was allegedly signed by William Frye (now deceased), Minnie Frank (now deceased), and Theodore Jake.

22. Theodore Jake, a member of the Coast Indian Community whose name appears on an undated consent form ostensibly agreeing to the granting of the right-of-way over the Rancheria to Del Norte County for an unspecified amount, denied that the signature on the document was his signature, for he signed his name in a different manner. A sample signature by the witness at trial appeared to be significantly different. Mr. Jake also testified that he never remembered anyone from the Simpson Company, the Government, or otherwise asking him about the road right-of-way or whether he would agree to such a sale.

Defendant has offered no evidence to refute the witness' denial of his signature on the document, which is irregular in that it is undated and not witnessed. The other two signators of the document, William Frye (husband of witness Dorothy Frye) and Minnie Frank, are both recently deceased.

23. The evidence shows that the Coast Indian Community in April 1966 was comprised of 13 families, and so a majority vote of the adult members required responses from more than the three persons whose names appear on the supposed consent form. The consent document offered in this case—undated, unwitnessed, and a generally irregular legal document—is thus insufficient to constitute the landholders' consent required by the statute and regulations.

24. There was also documentary evidence of still more consents, purporting to approve transfer of a roadway to the County in 1954. An all-important map identifying the road was not attached to the document, as the document indicated it was. This evidence undoubtedly relates to a public road which already ran through the eastern part of the Rancheria in 1966, with which the right-of-way at issue here connects, but which comprises no part of that right-of-way. The probative value of this consent document is negligible and this evidence has therefore been accorded no weight.

25. It is concluded that the BIA's conveyance of the right-of-way in the absence of the required consents was an act beyond the authority of the Government agents involved. Although this act was wrongful as to the Coast Indian Community members, and this wrongful act was not ratified by the United States, there was no constitutional taking for which the sovereign can be held liable under the fifth amendment.

26. A claimant must have a legal interest, not merely an equitable or beneficial one, in property taken by the Government in order to recover just compensation under the fifth amendment. Plaintiffs are beneficiaries of land acquired by the United States as trustee and their interest in the land, including the alienated right-of-way, amounts solely to equitable title in trust property. For this additional reason, plaintiffs are also unable to successfully claim a taking.

27. Witness Harold Del Ponte, County Supervisor, Fifth District, Del Norte County, California from January 1953 to January 1973, testified that he proposed the resolution accepting the road covering slightly more than a 2-acre area of the right-of-way in question into the county road system on October 24, 1972. Although the witness said that the transaction was an arm's length one, he admitted that he was not a real estate appraiser and had no professional experience as a basis for his opinion that the transaction was an arm's length one for full value. He also indicated that the acquisition price was decided solely by the BIA. Under cross-examination, he indicated that there was no

opposition to the proposal and the County easily approved it.

28. Witness Hugh Walcott, retired supervising forester of the Simpson Timber Company at Klamath, California, was with the company from April 3, 1950 until March 1, 1975. He was involved with land management and land acquisition activities at Klamath during all this period except from 1959 to 1966, when he was involved in the forestry side. The value of the testimony of this witness is slight for his recollection of the details of events relating to the acquisition of the right-of-way in question is meager and selective.

29. Witness H. A. Peterson, Jr., Chief Forester in the years 1965–1966 of the Simpson Company, Arcata, California, testified relative to the extent of Simpson Timber Company holdings in Del Norte County south of the Klamath River in 1965 and 1966, as verified from his office records.

In his testimony, Mr. Peterson was very guarded, cautious, at times somewhat equivocal. His testimony was unimportant.

30. The Government owed a fiduciary duty to the members of the Coast Indian Community in its management of the Rancheria, for the latter was held in trust by the United States for the benefit of the Coast Indian Community [25 U.S.C. §465 (1970)]. For this reason, the actions of the Government in this case, as accomplished through its agents, the local officials of the BIA, must be judged according to the standards applicable to a trustee engaged in the management of trust property.

31. The United States, when acting as trustee for the property of its Indian wards, is held to the most exacting fiduciary standards. These standards extend equally to the local agents of the BIA, and the responsibility of the trustee includes accountability for the acts of those agents, even where wrongful and unauthorized.

32. A trustee is under a duty to exercise due care and prudence to preserve the trust property. If the trustee is guilty of negligence in his dealings with that property, the trustee is liable to the beneficiary for any loss thereon.

33. Fraud or gross negligence in the actual conduct of the United States as trustee, or in the conduct of its agents, will make the Government liable for damages in breach of trust growing out of the fraud or negligence.

35. If the value realized from the trust property was so far below its fair market value as to constitute fraudulent conduct, gross negligence, or other breach of a fiduciary duty, this is sufficient in itself to establish the trustee's liability.

36. The defects in defendant's appraisal were so substantial and numerous as to make it thoroughly inadequate and incompetent. These defects include: (1) Mr. Heisel's breakline was incorrect, and far more sections of timbering area would have been harvested for removal over plaintiffs' right-of-way than the four sections that the BIA appraiser assumed; (2) the estimate of the volume to be harvested each year from the foregoing sections was incredibly low, and was so even taking only the four sections into account; (3) the appraisal ignored rising right-of-way fees in the area as well as the fact that those fees were usually coupled with reciprocal exchanges, without which the fees would reasonably have been even greater; (4) the difficulty and expense of obtaining alternate routes for timber removal was not considered; and (5) the estimated volume of timber traffic was at extreme variance with immediate past and present figures on such at the time the appraisal was made. Plaintiffs' expert accurately characterized the BIA valuation as deficient on these grounds, and Mr. Heisel, called as the Government's expert, failed to support his appraisal against this attack. Further, it is of no comfort to the Government's case that a memorandum signed by one of the BIA's own field representatives, Andrew Lathem, disclosed to the Sacramento area office an anticipated volume of timbering south of the Rancheria at great variance with assumptions of the appraisal finally relied upon. The memorandum, received by the BIA after Mr. Heisel conducted his appraisal but before the latter was approved as the basis for the right-of-way sale, noted the increased road construction activity in the interior of the timbering area, evidencing expectation of greater harvesting of the area in the near future.

37. The evidence in the instant case shows gross negligence on the part of the trustee's agent, the local office of the BIA, in attempting to ascertain a value for the right-of-way and causing plaintiffs to be damaged to the extent of the 2,000 percent difference between the nominal sale price, $2,500, and the fair market value of the conveyance, $50,000, a disparity which that on its face strains the normal legal concepts of fiduciary responsibility, even when considered most favorably to the trustee.

38. Although it is well established that interest from the date that the claim arises until date of judgment is not awarded as part of a recovery for breach of trust, further proceedings under Rule 131(c)(2) will be required to determine the disposition of the $2,500 actually received in payment for the right-of-way and the status of any other funds of the Coast Indian Community. If the payment received was held in the U.S. Treasury in a trust account for Coast Indian Community members, or if it can be shown that part of a larger realized amount would have been so held, it is possible that interest should be awarded under sections 161 and 161a [25 U.S.C. §§161 and 161a (1970)].

Ultimate Findings of Fact*

39. The members of the Coast Indian Community of 13 families, as designated beneficiaries settled on the Resighini Rancheria, own a compensable interest in the Rancheria.

40. Even though the grant of the right-of-way over the Coast Indian Community's property was unauthorized for lack of the requisite consents and constituted a wrongful act by agents of defendant, the sovereign did not ratify this wrongful act and thereby become liable for a constitutional taking.

41. Plaintiffs are entitled to recover for the Government's negligent conduct in the valuation of the right-of-way for sale to the County, as evidenced by the gross inadequacy and incompetence of the appraisal employed by

* Corrected per order issued concurrently

Syllabus

the BIA, and by the very wide disparity between market value and price.

42. The United States, having failed to act here in a manner that met the high fiduciary standards imposed upon it when it deals with Indian property as a trustee, must pay in damages for breach of its trust obligations, in an amount equal to the full market value that should have been realized upon the right-of-way sale ($50,000), less the sum actually paid to the BIA for the conveyance ($2,500).

CONCLUSION OF LAW

Previously, $2,500 was paid for the right-of-way. Thus, in accordance with the determination of value by the court, based on Mr. Kleiner's opinion, plaintiffs are entitled to a recovery as follows:

Value as of April 5, 1966	$50,000
Less prior payment	2,500
Net amount	$47,500

Further proceedings under Rule 131(c) will be necessary in order to determine the beneficiaries who are entitled to share in this award, and whether interest is awardable.

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549 F.2d 767

GRUMMAN AEROSPACE CORPORATION v. THE UNITED STATES

[No. 410–72. Decided February 23, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; disputes; cost-plus-fixed-fee contract; subcontract prices; defective pricing data; pre-Truth in Negotiations Act subcontracts.—Prior to enactment of the Truth in Negotiations Act, Pub. L. 87–653, plaintiff entered into a cost-plus-fixed-fee contract with the Navy for an improved type of radar-equipped, carrier-based aircraft. Plaintiff thereupon entered into a cost-type contract with Hazeltine Corporation for certain of the radar equipment required by the prime contract. Well into performance of that subcontract plaintiff negotiated three additional subcontracts with Hazeltine to obtain needed spare parts and modification kits for the radar equipment previously

Per Curiam

furnished by Hazeltine. While negotiating those additional subcontracts, which Hazeltine insisted be of a fixed-price variety, plaintiff, as required by Navy procedures, notified the latter's Bureau of Aeronautics (BAR) representative of the proposed contract terms, including price. By endorsement, the Navy representative signified approval of those terms "SUBJECT TO FURTHER INVESTIGATION AND REVIEW BY NAVY COST INSPECTION SERVICE AS TO REASONABLENESS OF PRICE." Under announced Navy policy, this endorsement signified that the BAR had reviewed the procurement and was satisfied that the contractor had exercised reasonable business judgment in making the award. Following receipt of these endorsements, and relying on their significance, plaintiff awarded Hazeltine the three subcontracts. Hazeltine completed performance of the subcontracts and received payment in full from plaintiff. The contracting officer, however, denied plaintiff reimbursement under its cost-plus prime contract for $394,097 of the amount that it had paid Hazeltine under the three fixed-price subcontracts, this on the theory that the prices in those subcontracts were excessive to that extent. This action, it appears, was precipitated by an investigatory report issued by the General Accounting Office. The report dealt with these contracts. It concluded, however, that plaintiff and the Navy were equally remiss in permitting Hazeltine to realize excessive prices on its fixed-price subcontracts. The record indicated that the Navy Inspection Service had never challenged these prices despite the express reservation noted on the BAR endorsements. The record also showed that plaintiff's knowledge of Hazeltine's costs, gained from the initial cost-plus subcontract, should have alerted it to the excessiveness of the latter's prices in the contracts for spare parts for the original equipment. In these circumstances, it is *held* that plaintiff and the Navy should share equally in the burden of Hazeltine's windfall of $394,097. Plaintiff therefore is entitled to recover one-half of that amount, $197,048.50, and accordingly judgment is entered for plaintiff in the latter amount.

Henry G. Beauregard, attorney of record, for plaintiff. *Raphael Mur, Robert W. Ballin, Stephen B. Clarkson, Thomas J. Touhey, and Sullivan, Beauregard & Clarkson*, of counsel.

Gerald L. Schraeder, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, NICHOLS and KASHIWA, *Judges*.

PER CURIAM: This case comes before the court on the joint motion of the parties, filed November 17, 1976, pursuant to Rule 54(b)(3)(iii), moving that the court adopt the recommended decision of Trial Judge George Willi,

filed July 19, 1976, pursuant to Rule 166(c) on the parties' cross-motions for summary judgment, as the basis for its judgment in this case. Upon consideration thereof, without oral argument, since the court agrees with the trial judge's recommended decision, as hereinafter set forth, it hereby grants the parties' motion and adopts the said decision as the basis for its judgment in this case. Therefore, plaintiff's and defendant's motions for summary judgment are both allowed in part and denied in part (as is set forth in the trial judge's opinion) and, accordingly judgment is entered for plaintiff in the amount of $197,048.50.

OPINION OF TRIAL JUDGE

WILLI, *Trial Judge:* This is a suit to review, subject to the constraints of the Wunderlich Act, 41 U.S.C. §§321–22 (1970), the Armed Services Board of Contract Appeals' (the Board) approval of a contracting officer's denial of reimbursement for $394,097 that plaintiff paid a subcontractor (Hazeltine) under three fixed-price purchase orders for certain radar equipment that it used in performing a cost-plus-fixed-fee prime contract to supply the Navy with an improved type of radar-equipped, carrier-based aircraft.

On a record that consisted of a stipulation of facts with a large number of appended documentary exhibits concerning both the immediate negotiations between plaintiff and Hazeltine and their prior (and almost contemporaneous) dealings with each other on the same type equipment, the Board found that the prices called for in the three challenged purchase orders were unreasonably high and therefore confirmed the denial of reimbursement to the plaintiff. *Grumman Aerospace Corp.*, 71–1 BCA ¶8881.

Plaintiff then brought suit here to upset the Board's determination. Examination of the record made at the administrative level revealed that apart from the ultimate question of whether the prices paid Hazeltine were or were not too high, in fact, one of plaintiff's major contentions before the Board had been that it was due reimbursement in any event because, in accordance with established procedure, it had submitted these subcontracts (together with their underlying pricing data) to the Navy for pre-

award review and was entitled to assume, from the Navy's affirmative acknowledgment of such review and lack of any stated objection, that it was acting reasonably when it thereafter awarded the business to Hazeltine on the terms proposed. Since the initial Board decision did not treat with this contention and since its proper evaluation required some additional factual determinations, the cause was remanded to the Board for these purposes by the court's order of March 8, 1974, 204 Ct. Cl. 809.

In a further opinion of September 8, 1975, the Board, with one member dissenting, adhered to its earlier conclusion that plaintiff was not entitled to reimbursement of the subcontract costs in suit. *Grumman Aerospace Corp.*, 75–2 BCA ¶11,493.

Counsel have since filed supplemental briefs and the matter is now ripe for decision.

It is important to note at the outset that the transactions underlying this controversy occurred prior to enactment of the so-called Truth In Negotiations Act on September 10, 1962 as Pub. L. 87–653, 76 Stat. 528. Of particular pertinence here is that portion of the Act requiring, *inter alia*, a subcontractor whose contract is expected to exceed $100,000 in price to provide the head of the procuring agency with a certificate of current cost and pricing prior to award of such a contract. 10 U.S.C. §2306(f) (1964). It appears[1] that much of the impetus for adoption of this legislation came from investigative findings of the General Accounting Office (GAO). It is therefore not surprising to

[1] Under the caption WHAT THE BILL DOES, the following explanatory statement appears in the identical House and Senate Reports on H. R. 5532, 87th Cong. 2d Sess. [2 U.S. Code Cong. & Ad. News, at 2477–78 (1962)]:

"Requires certificate from contractors performing under negotiated contracts that cost data are current, accurate, and complete

"In determining the price under many types of negotiated contracts the Government must rely, at least in part, on cost and pricing data submitted by the contractor or his subcontractor. *In recent years the General Accounting Office submitted several reports to the Congress on cases in which contractors received unwarranted profits because the data used in establishing target costs or prices were inaccurate, incomplete, or out of date.* Although many of these reports were on incentive contracts, the objective of avoiding enhanced profits through failure to inform the contracting agency of the most current, accurate, and complete cost data is equally desirable in other types of negotiated contracts.

"While the Armed Services Procurement Regulation now contains requirements for certification of cost and pricing data, *the General Accounting Office informed the*

find that the denial of reimbursement that is the subject of this suit was totally precipitated by post-audit activities and the ensuing recommendations of the GAO. As will appear, the timing and character of those findings and recommendations bear relevantly on the liability determinations to be made herein.

All facts recited herein are either as expressly found by the Board or as directly set forth in the parties' comprehensive stipulation of facts filed with the Board.

Plaintiff's prime contract with the Navy, the contract under which the subject cost reimbursements were withheld, was entered into on June 15, 1956 with the Bureau of Aeronautics.

The Navy's WF–2 attack early warning aircraft was designed and developed by plaintiff. One of its features was the AN/APS–82 airborne radar system. Plaintiff contracted with Hazeltine for the development of such a

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committee that its examination of major military procurement activities in the past disclosed that many noncompetitive procurements were being accomplished without obtaining certifications from Defense contractors and subcontractors.

"Section (e) of the bill would enact a requirement that prime contractors and subcontractors must certify that to the best of their knowledge and belief the cost of pricing data they submit is current, accurate, and complete. This certificate would be required for negotiated prime contracts of more than $100,000, changes or modifications involving more than $100,000 in contracts, subcontracts of more than $100,000 if the prime contractor and each higher tier subcontractor have been required to furnish such a certificate, and changes or modifications to such subcontracts involving $100,000 or such lesser amount as may be prescribed by the head of the agency. In addition, any prime contract or any change or modification to a prime contract under which such certificate is required must contain a provision that the price to the Government shall be adjusted to exclude any significant amounts by which the head of the agency determines that the price was increased because the cost of pricing data furnished was inaccurate, incomplete, or not current. The controlling date for such determination is the date that is as close to the date of agreement on the negotiated price as is practicable.

"The only exceptions from the requirement for cost certification and adjustment provisions are where the price negotiated is based on (1) adequate price competition, (2) established catalog or market prices of commercial items sold in substantial quantities to the general public, (3) law or regulation, or (4) in exceptional cases where the head of the agency determines that the requirement may be waived and states in writing his reasons for such a determination.

"The objective of these provisions is to require truth in negotiating. Although not all elements of cost are ascertainable at the time a contract is entered into, those costs that can be known should be furnished currently, accurately, and completely. If the costs that can be determined are not furnished accurately, completely, and as currently as is practicable, the Government should have the right to revise the price downward to compensate for the erroneous, incomplete, or out-of-date information." [Emphasis added.]

system in 1956 and ordered production models of the perfected system from it in April 1958.

In November 1958 and January 1959, plaintiff issued three letter-of-intent contracts to Hazeltine as forerunners of subsequent formal purchase orders for spare parts and modification kits to support the radar systems already on order from Hazeltine. After receiving these letter contracts Hazeltine began obtaining quotations from suppliers for the material needed to produce the spares and modification kits involved and placed firm orders for sizeable quantities of such material prior to the time that the letter contracts were converted into formal purchase orders. Plaintiff had no knowledge of these activities by Hazeltine.

On January 7, 1959, Hazeltine submitted specific price proposals for converting the two letter contracts pertaining to spare parts to formal purchase orders. The total price proposed by Hazeltine for the two orders was $2,994,084.65. In the negotiations that followed, plaintiff attempted to persuade Hazeltine to accept a flexible pricing arrangement for this procurement, as it had done on the earlier development and production contracts for the same equipment. Hazeltine insisted, however, on receiving fixed-price contracts.

The background against which plaintiff conducted the above negotiations included a memorandum of October 7, 1957, that had been issued it by the Navy's Bureau of Aeronautics Representative (BAR) stationed at Bethpage, Long Island. The memorandum was entitled: "Military Purchase Orders submitted to Bureau of Aeronautics Representative for review or approval; change in procedure." Paragraphs 2 and 3 of that memorandum provided:

> 2. Under present procedures an affidavit justifying the award and summarizing the bid information is attached to each military order in excess of $100. Under the revised procedures, affidavits will be required only on procurements exceeding $25,000. Orders under $25,000 will be subject to BAR review on a spot check basis. The Contractor's procurement file on these latter orders should contain all the information that was formerly shown on the affidavit.
> 3. Two (2) BAR endorsements are placed on each military order. *It is deemed advisable for mutual reasons*

to mention the significance of each endorsement. The inspection endorsement is placed on the Contractor's blue file copy. It signifies that the materials or services under procurement are considered by the BAR to be necessary as to kind, quality and quantity in the performance of the contract and that the type of Government inspection specified on the order is correct. *The procurement endorsement* is placed on the affidavit copy of the order. *It signifies that the BAR has reviewed the procurement and has determined that the Contractor exercised reasonable business judgment in making the award. If insufficient or unsatisfactory procurement information is furnished or if additional time is required to complete the procurement review, the BAR will return the order to the Contractor with only the inspection endorsement.* This action will permit the Contractor to release the order to the vendor thereby preventing delays in the procurement of critical or long lead items. The affidavit copy of the order will be retained and will not be endorsed until the BAR has completed the procurement review. [Emphasis added.]

* * * * *

On remand, the Board found that the above-referenced BAR memorandum applied to the purchase orders in suit. It said (75–2 BCA at 54,834):

> Most certainly on its face the 7 October 1957 BAR memorandum has application to each of the purchase orders in dispute. * * * An unquestioned reproduction of the BAR memorandum was stipulated into evidence and, as far as we know, its applicability to these transactions has not hitherto been challenged in the long history of these proceedings. In the absence of more substantial evidence to the contrary we find it was a viable document in 1959 when these purchase orders were issued.

Purchase Orders numbered G–49450, in the amount of $261,657, and G–56260, in the amount of $2,424,394, together with the underlying pricing data associated with them, were both submitted by plaintiff to the office of the Bureau of Aeronautics Representative prior to issuance to Hazeltine. These were the two orders for spare parts. The same procedure was subsequently followed with respect to Purchase Order No. 64547, in the amount of $364,482, covering the modification kits. The advance submission to BAR was in accordance with the October 1957 BAR

memorandum which is set forth in full in the Board's supplemental opinion. 75–2 BCA at 54,833–34. Consistent with that memorandum each of the purchase orders involved herein bore the following blanks for "inspection" and "procurement" endorsements, respectively:

| "APPROVED FOR
INSPECTION BY
BAR BETHPA[G]E, N. Y. PER_____" |
|---|

* * * * *

VALUE OF THIS P. O. ☐ OVER ☐ UNDER $25,000.00	☐ REVIEWED ☐ APPROVED ON THE BASIS OF AVAILABLE INFORMATION SUBJECT TO FURTHER INVESTIGATION AND REVIEW BY NAVY COST INSPECTION SERVICE AS TO REASONABLENESS OF PRICE. BAR BETHPAGE, N. Y. PER_____

None of the inspection endorsement blanks on the purchase orders placed in evidence before the Board bear the signature or initials of BAR personnel. In the context of the BAR memorandum this omission is not significant, however, because the procurement endorsement on each of the orders was executed on behalf of the BAR. Thus, a checkmark was placed on each of the orders signifying a value in excess of $25,000 and the REVIEWED box on each of them was similarly marked. The signature line on the orders for spares, Nos. G–49450 and G–56260, was executed on behalf of the BAR by Solomon Liebowitz. On No. G–64547, the order for the modification kits, the BAR endorsement was by "HK," identified by the Board as Hank Krasienko, Mr. Liebowitz' immediate superior.

While the dates on which the BAR representatives executed the procurement endorsements do not specifically appear (neither do the specific dates on which the three

orders were released to Hazeltine), the parties formally stipulated before the Board that the subject orders were not issued to Hazeltine until after submission to the BAR and completion of the review conducted by that office. In this proceeding the Government has not asked to be relieved of that stipulation. The purchase orders in evidence were dated, however; No. G–49450 was dated March 27, 1959; No. G–56260 was dated April 1, 1959; and No. G–64547 was dated July 9, 1959.

The parties also stipulated before the Board that Hazeltine completed deliveries under the spare parts orders, Nos. G–49450 and G–56260, by August 1, 1960 and under the modification kit order, No. G–64547, by April 1, 1960.

As to the qualifying language on the procurement endorsements referring to "* * * FURTHER INVESTIGATION AND REVIEW BY NAVY COST INSPECTION SERVICE AS TO REASONABLENESS OF PRICE," there is no evidence in the record indicating either that prior to completion of performance of the three purchase orders and final payment by plaintiff to Hazeltine thereunder the Navy Cost Inspection Service conducted any investigation or review of those orders or, if it did, that it ever took any exception to the prices specified therein. As earlier noted, it appears that the sole impetus for the ultimate denial of reimbursements to the plaintiff in respect of those orders came from GAO. That agency's findings and recommendations were set forth in an October 1962 draft report to the Congress and in the Comptroller General's subsequent final report, B–132974, transmitted to the Congress on March 29, 1963. Both of these reports are included in the Board record.

In summary, the GAO found that the prices paid Hazeltine were excessive by more than $400,000 for three basic reasons; first, because the prices proposed for the two spare parts orders included contingency allowances totaling approximately $194,500—allowances that were unwarranted because of actual experience already gained by Hazeltine in performing the cost-type production contracts for the operational units for which the spare parts were being obtained; second, because when Hazeltine quoted on both the spare parts and modification kit orders it had

already bought or had firm commitments to buy material components at prices some $220,000 less than it used in arriving at the prices that it quoted plaintiff; and third, because Hazeltine's quote on the modification kit order included material costs of $15,000 that related to two more kits than called for by the order.

The GAO did not intimate in either of its reports that plaintiff had any actual contemporary knowledge of the causes of Hazeltine's overpricing. Rather, the burden of its findings was on Hazeltine's nondisclosure. Thus, the draft report observed: "Had the Navy or Grumman obtained Hazeltine's most recent experienced costs or vendors' quotations before the formal purchase orders were awarded, they would have been in a sound position to negotiate a reduction in the purchase order prices of about $433,000." Moreover, GAO's comments uniformly assigned equal responsibility for what happened to both plaintiff and the Navy. That viewpoint is implicit in the statements with which GAO concluded its draft report, as follows:

Conclusion and recommendation

We believe that in negotiating the prices of purchase orders issued under Government cost-type contracts, current cost information, when available, should be considered by both the buyer and the seller in order that the prices they negotiate, which are borne by the Government, are fair and reasonable. From the foregoing, it seems evident that Hazeltine and Grumman failed to give proper consideration to the negotiation of prices of purchase orders G–49450, G–56260, and G–64547. It also seems evident that the Navy failed to exercise proper control over Grumman, its prime contractor, in permitting it to negotiate purchase order prices that provided for about $433,000 more cost than Hazeltine could reasonably expect to incur.

It does not seem reasonable that the Government should incur costs of $433,000 and Hazeltine benefit by that amount because the prices negotiated by Hazeltine and Grumman for the three purchase orders did not give effect to the most current cost information available and included a provision for contingencies that was unwarranted. We therefore recommend that the Navy and Grumman take all available and appropriate action to obtain proper recovery from the Hazeltine Corporation.

> We believe that this case demonstrates the need for the Navy to maintain closer surveillance over subcontract pricing. We therefore recommend that the findings in this report be brought to the attention of Navy contracting officials, including those directly responsible for reviewing contract costs, to illustrate the need for more careful review of subcontract cost to be borne by the Government.

GAO transmitted copies of its draft report to plaintiff, Hazeltine and the Navy. In response, Hazeltine took the position that the purchase order transactions were completed and closed; that there was no provision in the orders authorizing a reopening, and that it declined in any event to make any voluntary price readjustment. Plaintiff advised the Comptroller General that it knew of no means or measure by which it could compel Hazeltine to disgorge any part of the prices that it had received. It appears that the Navy's reaction to GAO's recommendation that it attempt to effect some recovery from Hazeltine was simply notification to plaintiff that the Navy was holding it responsible under its prime contract. In practice, this was what the Navy did and hence the present litigation.

The various comments received by the Comptroller General did not alter the conclusions and recommendations contained in his draft report. Thus, he adhered in his final report to the basic premise that the real villain in the piece was Hazeltine,[2] who was only able to reap excessive subcontract prices because of the mutual failure and/or inability of plaintiff and the Navy to sufficiently scrutinize the cost justification for the prices that it sought. The Comptroller did not suggest or imply, however, that Hazeltine had achieved its pricing objectives by resort to fraud or affirmative deceit.

That the transaction involved in the present suit was a classic illustration of the need for legislation requiring

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[2] In his final report (B–132974) the Comptroller General stated:
"* * * it is not reasonable that Hazeltine should retain the $428,800 it acquired by seeking purchase orders on a fixed-price basis and then fail to base its price on information available on the costs it would in all likelihood incur in performing under the contract." The Comptroller did not, however, offer any suggestions as to how either plaintiff or the Navy could effectively recoup this apparent windfall from Hazeltine. *See, e.g., United States* v. *Systron-Donner Corp.*, 486 F.2d 249 (9th Cir. 1973).

advance disclosure of the costs on which contractors' bid proposals were predicated was expressly recognized by the Comptroller General.

Under the caption *Conclusion* his final report stated:

> The new requirement [speaking of the Truth In Negotiations Act] for the furnishing of cost or pricing data should result in agency officials' obtaining the information needed for proper evaluation of prices proposed by subcontractors. If such data are properly utilized, the recurrence of situations such as those described in this report can be prevented.
>
> Since the Navy has informed us that it will seek an appropriate recovery from Hazeltine and that we shall be advised of the recovery made, further action on this matter by our office will be held in abeyance pending advice from the Navy on the results of its attempts to obtain recovery from Hazeltine.

Experience has shown that the Act has at least the potential to prevent what occurred here. *M-R-S Mfg. Co. v. United States*, 203 Ct. Cl. 551, 561, 492 F.2d 835, 841 (1974).

In its initial opinion (71–1 BCA ¶8881) the Board affirmed the contracting officer's disallowances on the stated premise that the prices contained in the three Hazeltine purchase orders were unreasonably high. The opinion reached that conclusion by basically tracking the findings of the GAO. That overcharges in at least the approximate amount perceived by the GAO occurred has never been placed in any substantial doubt. As far as it went, therefore, the Board's conclusion is unassailable. That conclusion, however, stops short of the ultimate inquiry presented by the particular circumstances of this case. The question that must be confronted is; assuming Hazeltine's retention of its windfall gains, who, as between plaintiff and the Navy,[3] should bear the financial responsibility for those unmonitored gains? To assess plaintiff's relative responsibility in the matter requires more than a bare determination that the prices it paid Hazeltine were too high. The controlling question must be whether plaintiff acted reasonably when it awarded Hazeltine

[3] The GAO's reports clearly reflect the view that the Navy was at least as much responsible as the plaintiff for failure to timely uncover the excessive pricing that occurred.

contracts with prices that in the light of Hazeltine's actual knowledge were higher than they should have been. Given plaintiff's unawareness, in fact, of what Hazeltine was up to, it is on that issue that the BAR memorandum and plaintiff's advance submission of the proposed orders for BAR review become most relevant. The need for exploration of those matters necessitated the remand.

As already noted, the Board acknowledged on remand that the 1957 BAR memorandum covered the orders in suit. The memorandum specified that a procurement endorsement "* * * signifies that the BAR has reviewed the procurement and has determined that the Contractor exercised reasonable business judgment in making the award." It then goes on to state that: "If insufficient or unsatisfactory procurement information is furnished or if additional time is required to complete the procurement review, the BAR will return the order to the Contractor with only the inspection endorsement." On remand, the Board found that the three purchase orders were returned to the plaintiff with the procurement endorsement blank on each of them completed by a checkmark in the REVIEWED box and a signature by a BAR employee in the space provided for acknowledgment of the review. The Board went on to hold, however, that these were not "procurement endorsements" within the meaning of the BAR memorandum because the endorsers, although employed as procurement analysts in the office of the BAR and having the review of purchase orders among their principal duties, were not contracting officers and were therefore without authority to formally approve purchase orders. This analysis misses the point, however. The question is not whether the individuals involved had the capacity to bind the Government to the pricing terms of the proposed orders that were submitted to them but whether they were competent to perform the review contemplated by the BAR memorandum—a review that signified no more than a tentative approval as to price subject to the express contingency of later revision by the Navy Cost Inspection Service. There is nothing in the BAR memorandum or elsewhere indicating that only a contracting officer would be deemed to have that competence.

Moreover, the stated contingency never materialized; either because at no time during the period of more than a year between award of the orders to Hazeltine and its completion of performance thereunder, did the Inspection Service elect to make a follow-up audit or, if it did, because it found the terms of the orders to be satisfactory.

The Board noted that poor health prevented Mr. Krasienko, who endorsed the purchase order for modification kits, from testifying in the remand proceeding. It related, however, that his subordinate, Mr. Liebowitz (who endorsed the two orders for spares) testified that: "My initials were an indication to Grumman that I had reviewed that particular purchase order, and I had no further questions on it. During that period of time, the volume was so great, the Grumman purchasing people, by seeing my initials up front, would know right away that they had no problem with that particular purchase order." The witness went on to acknowledge what was explicit in the terms of his endorsement; that he did not have authority to commit the Government to final approval of the orders.

The foregoing factors combine to impel the conclusion reached by the dissenting Board member (75–2 BCA at 54,838–39); that each of the purchase orders involved carried a procurement endorsement within the meaning of the 1957 BAR memorandum. Accordingly, were it not for the fact that when plaintiff was negotiating the spare parts orders with Hazeltine it was in midstream of a fixed-price-redeterminable production subcontract with the same supplier for the same materials, the entire amount ($394,097) of the withheld reimbursements should be awarded it because of the presumption of reasonableness arising from its compliance with the provisions of the memorandum. A negotiating vantage point reinforced by the sources of intelligence that were available to plaintiff imposed an obligation on it to subject Hazeltine's proposals to a much more informed and penetrating scrutiny than could have been expected in a first-time procurement situation. The Comptroller General concluded, reasonably, that Hazeltine's incorporation of a flat 10 percent contingency increment in its price proposals for spares and its

assignment of higher prices to certain material components than those used for the same items in its price-redeterminable production contract could probably not have survived such scrutiny. That plaintiff was not as alert in its dealings with Hazeltine as it might have been does not rationally suggest, however, that it should bear the total burden of the latter's windfall. Because the entire matter of that windfall was brought to light by the Comptroller General only after "the horse had been stolen," in terms of performance by and payment to Hazeltine, and since the Comptroller's investigation led him to conclude that the Navy was at least as remiss in the matter as plaintiff, the preferred result is one shaped by equitable principles that apportion liability in accordance with relative fault. *Dynalectron Corp.* v. *United States*, 207 Ct. Cl. 349, 368, 518 F.2d 594, 605 (1975). The particular facts of this case fully support the GAO's conclusion that the fault was equal. The economic burden should be distributed accordingly.

CONCLUSION

For the reasons given, plaintiff's and defendant's motions for summary judgment are both allowed and denied in part. Judgment is entered for the plaintiff in the amount of $197,048.50.

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550 F.2d 26

LEWIS-NICHOLSON, INC., W. J. NICHOLSON AND BLASI-ENGELKE CO., A JOINT VENTURE v. THE UNITED STATES

[No. 93–73. Decided February 23, 1977]

ON THE PROOFS

Contracts; breach; hindrance of performance by other party.— Plaintiff, highly experienced in road and highway construction particularly in mountainous areas, entered into a contract with the Bureau of Public Roads for the clearing, grading and construction of 7.565 miles of California Forest Highway Route 24 in the High Sierras. Plaintiff timely commenced operations and satisfactorily completed the contract

Per Curiam

work in a little less than three-quarters of the time allowed to it under the contract. This result was accomplished through a late acceleration of performance in order to complete the job within two construction seasons. Plaintiff claims the Bureau breached the contract in that it unjustifiably and unreasonably delayed performance causing plaintiff to incur damages arising out of inefficient and more costly operations, performance of work during adverse weather conditions, etc. It is *held* that plaintiff is entitled to recover damages because defendant breached contract obligations not to unreasonably interfere with or delay contract performance. The trial record generally shows inadequate advance planning by the Bureau, failure to coordinate and consult with the United States Forest Service on such advance planning as was done, some timidity and indecision on the part of the project engineer possibly attributable to inexperience with difficult and mountainous terrain, numerous staking delays and errors, an undermanned survey crew, all culminating the misunderstandings and communication failure with resulting hostility between the defendant and contractor personnel. Judgment is entered for plaintiff with the amount of recovery to be determined pursuant to Rule 131(c).

Contracts; breach; prevention or hindrance of performance by other party.

[1] There is an implied obligation in every contract, whether it be one between individuals or between an individual and the Government, that neither party to the contract will do anything to prevent performance thereof by the other party or that will hinder or delay him in its performance. Thus, where the record indicates that the Government imposed delays, errors and deficiencies upon the contractor which unreasonably interfered with and delayed contract performance, the contractor is entitled to recover damages for additional expenses incurred for breach of the implied obligation.

United States ⚖74(14)

Stuart R. Pollak, attorney of record, for plaintiff. *Robert E. Gooding* and *Howard, Prim, Rice, Nemerovski, Canady & Pollak*, of counsel.

Robert M. Hollis, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, KASHIWA and KUNZIG, *Judges*.

PER CURIAM: This case comes before the court on defendant's exceptions to the recommended decision of Trial Judge Lloyd Fletcher, filed June 22, 1976, pursuant to Rule 134(h), having been submitted on the briefs and oral argument of counsel. Upon consideration thereof,

since the court agrees with the said recommended decision, as hereinafter set forth*, it hereby affirms and adopts the decision as the basis for its judgment in this case. It is therefore concluded that plaintiff is entitled to recover and judgment is entered for plaintiff with the amount of recovery to be determined pursuant to Rule 131(c).

OPINION OF TRIAL JUDGE

FLETCHER, *Trial Judge:* This contract case involves the building of a mountain road in the Sierra Nevada and presents a study in what, during a moment of frustration, one employee of the contractor described as "chaos and confusion." While this rhetorical description is overstated, the trial record generally shows inadequate advance planning by the Bureau of Public Roads (BPR), failure to coordinate and consult with the United States Forest Service on such advance planning as was done, some timidity and indecision on the part of the Project Engineer possibly attributable to inexperience with difficult and mountainous terrain, numerous staking delays and errors, an undermanned survey crew, all culminating in misunderstandings and communication failures with resulting hostility between Government and contractor personnel. These problems are detailed in the findings of fact below. Here they will be summarized to the extent necessary to show that the defendant must be held to have breached its contractual obligation not to prevent, interfere with, or unreasonably delay the contractor's performance.[1] See, *J. G. Watts Const. Co.* v. *United States,* 174 Ct. Cl. 1, 355 F.2d 573 (1966).

Plaintiff is a joint venture registered in the State of California. Its management personnel have all had extensive experience in the construction of roads and highways, particularly in mountainous areas involving heavy rock

* Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed June 22, 1976, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

[1] The trial judge to whom this case was originally referred, directed that the initial trial be limited to the issues of law and fact relating to plaintiff's right to recover, as contemplated by Rule 131(c). Hence, the determination of the amount of recovery, if any, has been reserved for further proceedings.

excavation, extensive clearing and grubbing coupled with bridge construction and paving work. One of plaintiff's important managers was Richard A. Lewis who has had long experience in mountain road construction and who was assigned by plaintiff to be its project manager for the job here involved.

On May 29, 1967, BPR issued an Invitation for Bids for California Forest Highway Project 24–1(3), calling for clearing, grading, and construction of a concrete girder bridge on 7.565 miles of California Forest Highway Route 24.[2] The stretch of road to be constructed under the contract was described in the IFB as "located approximately 5 miles south of Blairsden, California, beginning at the south boundary of Plumas County, and extending 7.565 miles (including 0.020 mile bridge) northerly to a junction with State Route 89 near Graeagle, California." The site is about 50 miles northwest of Lake Tahoe, Nevada.

After visiting and viewing the project site, representatives of the plaintiff joint venture prepared their cost estimates and on June 29, 1967, submitted a bid in the amount of $1,295,354. Plaintiff was awarded the contract on July 7, 1967.

On the occasion of his initial visit to the site, Lewis and his companions walked the entire right-of-way. He noted that the BPR had staked nearly all the center, or control, line and had even installed some slope stakes at the lower end of the project. To him, this "decent start" meant that he could count on the job being "pretty well staked before we would get any amount of activity." Normally a road building contractor is entitled to assume that, prior to the start of construction, the property owner will have substantially completed the construction staking necessary to guide the contractor's construction crews, and plaintiff's bid was based on such an assumption. A prudent contractor, however, also recognizes that some changes may become necessary as work progresses. This fact is reflected in the present contract by the following provision:

> 4.2 Changes. It is mutually agreed that it is inherent in the nature of highway construction that some changes

[2] See Map of Location Plan attached to findings of fact.

in the plans and specifications may be necessary during the course of construction to adjust them to field conditions and that it is of the essence of the contract to recognize a normal and expected margin of change within the meaning of the clauses "Changes" and "Changed Conditions" in the "General Provisions" of the contract as not requiring or permitting any adjustment of contract prices, provided that any change or changes do not result in (1) an increase or decrease of more than 25 percent in the original contract amount, in the quantity of any major item, or in the length of project, or (2) a substantial change in the character of the work to be performed under a contract pay item or items that materially increases or decreases the cost of its performance.

As previously stated, the construction contract was awarded to plaintiff as low bidder on July 7, 1967, for a contract price of $1,295,354. It provided for commencement of work within 10 calendar days after receipt of notice to proceed and required completion of the work within 320 calendar days subject to authorized extensions. It incorporated by reference the "General Provisions (Standard Form 23–A)," Public Roads Specifications FP–61, Special Provisions and Bid Schedule for this particular job referred to briefly as "F.H. 24–1(3), Gold Lake," together with 50 sheets of construction plans.

Lewis and two associates were primarily responsible for the development of plaintiff's plan for the performance of this contract. Their planning centered around a basic assumption that the entire job could be accomplished in two construction seasons, i.e., 1967 and 1968.[3] With this fundamental objective in mind, plaintiff's personnel established as a matter of first priority the performance of clearing the entire job during the 1967 construction season. This was deemed absolutely necessary to the end that all the clearing debris could be disposed of by burning during the one intervening winter season which was the only time that the United States Forest Service would permit any

[3] Due to the prevalence of snow and other adverse weather conditions, it is generally impossible to perform road construction work in the High Sierra Mountains during the winter months and early spring. Hence, a "construction season" as that term is used herein refers to a period beginning in middle or late April and extending into early or middle November.

significant burning operations. Of course, plaintiff's personnel also hoped to perform as much actual construction work as possible during the first year, and because of access problems[4] they further deemed it essential to complete substantially the construction of the bridge involved, the latter work having been subcontracted by plaintiff.

On July 25, 1967, following some preliminary meetings, a formal preconstruction conference was held by which time the BPR project engineer, Douglas McCullough, had arrived at the site. During this conference, plaintiff's representatives repeated their previously expressed intentions to perform all clearing operations, and to complete the bridge over Frazier Creek during the 1967 construction season. They also designated specific areas where they desired to begin clearing operations. One of these areas, however, encompassed a line change which had not yet been fully designed. Accordingly, McCullough gave plaintiff the option of waiting for the line change to be completed, or, alternatively, of simply clearing to the clearing flags then installed at approximate locations. From prior experience in performing clearing operations to approximate locations, plaintiff's representatives had determined that such procedure was inefficient and costly because of the possibility that reclearing would later become necessary. Consequently, plaintiff chose the option of awaiting the completion of the new line change with subsequent setting of slope stakes and precise clearing flags before performing any clearing operations.

There was also discussion at the preconstruction conference of the critical McGovern Area lying between Stations 740 and 759. Plaintiff's superintendent stated his intention to begin work in that area "right away," in order

[4] Plaintiff recognized that access to the project was quite limited and presented a definite problem for its construction operations. There was access to the project from public roads at its beginning at Station 417, as well as at its end at Station 828. Further, two public roads intersected the project at approximately Stations 470 and 740. Thus, plaintiff was assured of access to the project only at four locations: Station 417, Station 470, Station 740 and Station 828. In addition, a few private roads intersected the project and constituted possible access points. As noted below, one of these (the McGovern road) was later used extensively by the contractor albeit under difficult circumstances.

that the area could be cleared and provide access to the upper part of the bridge site. Despite the fact that the area from Station 740 to 759 was fully slope-staked and ready for plaintiff's construction operations, the plaintiff was not permitted to perform work within the area until further studies were made with respect to the problem of the McGovern water supply, described below.

Shortly after the preconstruction conference, BPR issued its Notice to Proceed. Plaintiff timely commenced construction operations and satisfactorily completed the contract work on November 16, 1968. The work was completed by plaintiff in a little less than three-quarters of the time allowed to it under the contract. This result was obtained by plaintiff through a late acceleration of its performance in order to complete the job within two construction seasons which all agreed was the cheapest and most efficient approach.

From the beginning of the work, plaintiff was plagued with errors by BPR personnel in the setting of major construction stakes. Under the contract, it is the responsibility of the BPR project engineer to set all construction stakes which, in the words of the contract, "shall constitute the field control by and in accordance with which the contractor shall govern and execute the work." The major construction stakes are clearing flags,[5] slope stakes,[6] culvert stakes,[7] reference point (RP) stakes,[8] and bank plugs.[9]

From the extensive record herein, both testimonial and documentary, I have found as an ultimate fact that the

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[5] Under standard procedures, these flags can be set accurately only by reference to slope stakes.

[6] Slope stakes are the basic guide for the contractor's excavation and embankment operations. They are set at 50-foot intervals along the roadway alignment, with two stakes being set at each location. At any given location, the two slope stakes will mark the outer limits of construction for the road at that point. The slope stake will, in other words, define the point on the ground where the contractor will either begin to excavate, or begin to place embankment.

[7] Define the location, slope, and length of metal culverts placed across the roadway for drainage purposes.

[8] These stakes are placed outside the construction area and contain all information necessary to re-establish slope stakes and culvert stakes when destroyed in the course of construction.

[9] Bank plugs are set to furnish the contractor with necessary information as to the final exact elevation of the roadbed.

Government's performance of the required surveying and staking was unreasonably slow and that an unusual number of staking errors were negligently made. This conclusion is fully supported by the many references to continual staking problems in the vast majority of BPR monthly inspection reports, weekly narrative reports, and construction diaries from the commencement to very near the end of the job. A tedious quotation of these numerous entries seems unnecessary here, but it is worth recording that a substantial part of the delay is fairly attributable to an insufficient number of personnel on BPR crews, frequent turnover of such personnel, low morale, and lack of previous survey experience.

Whether all of the deficiencies had any significant impact upon plaintiff's operations, however, must await further determination.[10] The record developed thus far on the severed issue of liability clearly shows that coupled with further problems yet to be discussed, the magnitude of the BPR staking errors was such as to constitute a breach of the Government's contractual obligation not to interfere with or delay the contractor's performance, but it does not show the extent, if any, of actual monetary harm caused to plaintiff thereby. While the BPR staking errors and center line changes posed a serious problem for this plaintiff, they were not as massive in their impact on construction operations as the errors found in the *J. G. Watts Const. Co.* case, *supra*. If the staking errors were the only factors involved in this case, a finding could possibly be justified to the effect that their impact on plaintiff's operations was not sufficient to constitute a breach of contract. For example, the court found in *Watts* that over one-half of all slope and reference point stakes were in error, a percentage considerably in excess of the number of errors committed by BPR in the present case. However, the staking errors in this case were compounded by a unique problem that arose in an area known as the "McGovern Area", which was a difficult and critical portion of the road lying between Stations 740 and 759.

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[10] See footnote 1, *supra*.

Mrs. J. G. McGovern was an employee of the U.S. Forest Service and the widow of a deceased Forest Supervisor in the area. Pursuant to a special use permit issued by the Forest Service, she occupied a house in the vicinity of the roadway alignment between Stations 743 and 750. Mrs. McGovern's house was supplied with water from two natural springs. One of the springs was located almost on the center line of the planned roadway slightly ahead of Station 747. A water line ran from this spring down the slope to Mrs. McGovern's garden, and this particular spring served as her garden water supply. The second spring was located outside the upper clearing limit at approximately Station 747+50. A water line from this spring ran down across the roadway alignment to Mrs. McGovern's house, and served as the water supply for the house.

The facts described in the preceding paragraph were well known to BPR personnel prior to issuance of the bid invitation, and the contract plans covering the McGovern segment showed the existing main water line indicating that it was "to be relocated" under Force Account, *i.e.*, on a cost plus basis over the contract price. While the plans also showed the existing "secondary water line," there was no indication as to what was to be done with it. The subsequent difficulties and delays which arose during construction were apparently not anticipated although they should have been if BPR had done more adequate advance planning including consultations with Mrs. McGovern and the Forest Service. That this is now recognized by BPR is evidenced by the following recommendation contained in the Final Construction Report covering this project:

> 2. If possible, definite needs of Forest Service permittees [such as Mrs. McGovern] should be established before start of construction.

So far as this record discloses, no effort whatever was made by BPR in advance of construction to establish Mrs. McGovern's rights and water supply needs. The foregoing recommendation is a commendable and forthright recogni-

tion that such an effort should have been made and presumably would be made in the future.

Because of the available access road at Station 740, normal and efficient road building procedures would be to commence area clearing from Station 740 back on line towards the 700 bog and also ahead on line to Station 760 for the purpose of developing access to the bridge site. For these reasons, plaintiff's superintendent stated his intention to begin work in that area "right away." However, at the preconstruction conference held July 25, 1967, plaintiff was advised by BPR for the first time of a possible legal problem in the McGovern Area and was requested to stay out of the area until the problem was resolved. On August 15, 1967, at a meeting with Mrs. McGovern and representatives of the BPR and Forest Service, plaintiff was advised that it should perform no construction work in the McGovern Area because of the possibility that Mrs. McGovern's water supply would be damaged or completely destroyed. Mrs. McGovern was convinced that she was entitled to a temporary water supply during construction and she was supported in this view by the Forest Service. BPR, therefore, set about the designing of an alternate water system which resulted in Change Order No. 1 which was approved October 17, 1967.

As a result of the foregoing problems, plaintiff was prevented from working in the McGovern Area near Mrs. McGovern's water lines and water system from the start of construction until October 27, 1967. This constituted an unreasonable delay to plaintiff's construction operations which could have been prevented by BPR if the obvious problem of the McGovern water system had been solved prior to the issuance of its Notice to Proceed. See, *Delta Equipment & Construction Co.* v. *United States*, 125 Ct. Cl. 632 (1953) where an excavation contractor was held entitled to recover excess costs incurred by it as a result of delays by the Government in obtaining unobstructed access to the worksite. See, also, *Dale Construction Co.* v. *United States*, 168 Ct. Cl. 692, 700 (1964) upholding a claim for damages resulting from delays caused by the Government's failure to make the worksite available.

Not only were plaintiff's clearing operations delayed and otherwise adversely affected by the Government's prohibition against working in the McGovern Area. A further complication ensued from the prohibition. If plaintiff had been permitted at the outset of construction operations to work in the area, the record clearly indicates that it could have cleared the right-of-way itself in order to obtain full access to the uphill side of the bridge site by way of the access road at Station 740. Since all agreed that it was important to complete substantially the bridge over Frazier Creek during 1967, and since access to the uphill side of the bridge was essential to this objective, plaintiff had to resort to obtaining such access by means of using a small private road leading to the McGovern house. Since Mrs. McGovern would permit the issuance of only a single key to the gate guarding her road to be carried by a supervisor, men and equipment were often delayed in gaining access to or from the bridge site. Also, the contractor was required to perform continual maintenance of the private road, and to perform other additional and miscellaneous work to procure and retain Mrs. McGovern's consent to the use of her road. This complex and unusual operation further delayed the plaintiff without its fault or negligence.

The final delay problem in the McGovern area arose because during the 1967 construction season, it became apparent to BPR that the steepness of the sidehill and the existence of several springs in the area posed a serious stability problem. A collapse of the fill would endanger the McGovern residence. It was decided, therefore, to make design changes so as to provide embankment foundation drains and compaction bench[11] giving additional stability to the fill. The delay occurred because BPR did not commence the necessary design work until after the start of the 1968 construction season, and the appropriate directives and change orders were not forthcoming until the months of May and June 1968. The result was that plaintiff could not commence unrestricted grading in the

[11] A compaction bench can best be described as a narrow "road" cut at the bottom of the embankment in order to provide a base upon which the embankment can rest. The embankment is built up layer by layer from this base, and is therefore less likely to slide down the slope.

area until near the end of June. But for this delay, ground conditions were such that plaintiff could have commenced its grading around the end of April.

Finally, there were Government-caused delays to plaintiff in the failure of the project engineer to designate feasible stockpile sites for temporary storage of unsuitable material[12] and to complete in a timely manner a major grade change in the roadway at a major cut near Station 660.

There were two marshy areas along the roadway alignment from which it was necessary to excavate unsuitable material which areas became known as the "600 Bog" and the "700 Bog." The unsuitable material thus excavated was to be placed on fill slopes, but since such excavation preceded the construction of the fill slopes, it was necessary to store the unsuitable material temporarily in stockpiles. Such designations of stockpile areas as were made by the project engineer were impossible to reach at the particular stage of construction at the time of designation. Plaintiff's representatives complained of this on numerous occasions without result and finally plaintiff resorted to a technique known as "half-width construction" which involves using one-half the roadway as a stockpile area.

As a result of not being timely furnished with feasible stockpile sites for temporary storage of unsuitable materials, the contractor was unreasonably delayed in gaining full access through the 600 and 700 bog areas. This delay caused duplication of effort with resulting inefficiency in the contractor's operations, especially with respect to operations in the areas between the two bogs and in the moving of the unsuitable material. These inefficiencies extended from late 1967 until September 1968, when unrestricted access through the bogs was finally achieved.

By the close of the 1967 construction season, BPR had concluded that a major grade change in the area of Station

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[12] In the contract specifications, unsuitable material is described as "unstable material or other material which is unsuitable for foundation, roadbed, or other roadway purposes." Such unsuitable material is frequently used in slope flattening, but prior to the construction of the necessary slopes, the material must be stockpiled in areas designated by the project engineer.

660 was appropriate. Although it is reasonable to infer that such a grade change could have been fully designed at BPR headquarters, during the winter months, the only work in this regard accomplished during that period was the processing of the collected data through the BPR computer. The actual design work was not commenced until approximately two months after the startup of construction in the spring of 1968. It had been previously determined that the grade change would be made at the major cut near Station 660. It was not until June 15, 1968, however, that the project engineer had completed the design for this grade change and had attended to the necessary restaking of the area incident thereto.

Because of the restriction on construction activities in the McGovern Area, coupled with the absence of a feasible stockpile site, plaintiff was unable to handle the unsuitable material and to excavate the 660 cut from both directions in a normal and efficient manner. The combined effect of BPR delays in making the 660 grade change, in making the necessary design changes in the McGovern Area, and in failing to designate feasible stockpile sites was to delay the contractor until early September 1968 in developing unrestricted access from the 740 access road back on line.

It must be obvious from the foregoing description of the Government-caused delays in the performance of this road construction contract that the Government has breached the "implied provision of every contract, whether it be one between individuals or between an individual and the Government, that neither party to the contract will do anything to prevent performance thereof by the other party or that will hinder or delay him in its performance." *George A. Fuller Co.* v. *United States*, 108 Ct. Cl. 70, 94, 69 F.Supp. 409, 411 (1947). Indeed, not only must the Government refrain from hindering the contractor's performance, it must do whatever is necessary to enable the contractor to perform. *Kehm Corp.* v. *United States*, 119 Ct. Cl. 454, 469, 93 F.Supp. 620, 623 (1950). To the same effect are *J. G. Watts Const. Co.* v. *United States, supra; Delta Equipment & Const. Co.* v. *United States, supra; Peter Kiewit Sons, Co.* v. *United States*, 138 Ct. Cl. 688, 151 F.Supp. 726 (1957); *H. John Homan Co.* v. *United States*,

Conclusion of Law

189 Ct. Cl. 500, 418 F.2d 522 (1969); *Dale Const. Co. v. United States, supra.* *See,* generally, Speck, *Delays - Damages on Government Contracts,* 26 Geo. Wash. L. Rev. 505, 518 *et seq.* (1958); and Seltzer & Gross, *Federal Government Construction Contracts: Liability for Delays Caused by the Government,* 25 Ford. L. Rev. 423 (1956).

Although not ordered by BPR to do so, plaintiff accelerated its performance in September and October of 1968 in order to ensure completion of the project before the onset of winter weather. This was done even though plaintiff still had over 100 contract days within which to complete its performance because of its concern, according to plaintiff's representatives, that it should mitigate its damages which otherwise might increase substantially in the event completion of the contract was delayed until the spring of 1969.

In light of the foregoing facts, I have concluded that defendant has breached its contractual obligation not to unreasonably interfere with or delay plaintiff's performance under Contract No. F. H. 24–1(3). Accordingly judgment herein should be entered for plaintiff with the determination of the amount of recovery to be reserved for further proceedings under Rule 131(c).

CONCLUSION OF LAW

Upon the trial judge's findings and opinion, which are adopted by the court, the court concludes as a matter of law that plaintiff is entitled to recover and judgment is entered to that effect with the amount of recovery to be determined under Rule 131(c).

Syllabus

551 F.2d 1208

S.W. AIRCRAFT INC. AND WESTERN HELICOPTER SERVICES, INC. v. THE UNITED STATES

[No. 37–75. Decided March 23, 1977]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; helicopter lease agreement; insurance proceeds; damages.—Western Helicopter Services (Western) subleased a helicopter owned by S.W. Aircraft (Aircraft) to the Department of Agriculture for use by the Forest Service in connection with its firefighting activities. In June 1973, while circling a suspected fire location and while flying below 500 feet from the terrain, the helicopter crashed, caught fire and was destroyed. At the time of the crash it was being directed to the site of the fire by a Forest Service aerial observer, but the pilot was not instructed to fly at any specific altitude. The craft was jointly insured by Aircraft and Western, and following the crash the insurance company, via the loan receipt method, paid plaintiffs its maximum liability under the contract, $38,000. Plaintiffs seek to recover the value of the helicopter pursuant to the "risk of loss" provision in the rental agreement. It is *held* that the receipt by plaintiffs of the insurance proceeds does not bar this suit since the Government did not pay premiums to cover insurance for this type of helicopter accident. It is also *held* that since the "risk of loss" provision is ambiguous in that it does not require that the pilot be specifically instructed to fly at less than 500 feet but only requires that the flight itself be Government-directed, the risk of loss was on the Government. It is also *held* that plaintiffs are entitled to damages in the amount of $42,000, the market value of the craft at the time of the accident, but are not entitled to interest. Under the terms of the insurance loan agreement, plaintiffs are required to return the previously paid insurance proceeds. Defendant's motion for summary judgment is denied, plaintiffs' cross-motion is granted and judgment is entered for plaintiffs for $42,000.

Pleading and practice; parties; standing to sue or be sued.

[1] The owner of a helicopter leased to another who rented the craft to the Government may not only maintain a suit against the Government for loss of the craft, *qua* owner, but also as named paid insured on an insurance loan agreement.

United States ⚿135

Contracts; insurance; loss covered by insurance loan agreement.

[2] Where the Government did not pay for insurance to protect it against liability resulting from destruction of the rented helicopter occurring on Government-directed observation flights at under 500 feet in elevation but did agree to pay for losses resulting from an accident to the helicopter occurring on said flights at under 500 feet in elevation,

the Government is not entitled to the benefit of the proceeds of the insurance loan agreement between plaintiffs and the insurance company; plaintiffs' receipt of the insurance proceeds does not bar the present suit for damages.

Damages ⚖64

Contracts; interpretation; ambiguity.

[3] Ordinarily, in interpreting a contract or statute, the court looks to the plain meaning of the contract language; but where the language is susceptible of two meanings and the contractor's interpretation is reasonable, the ambiguity will be construed against the Government as drafter of the contract.

United States ⚖70(3)

Contracts; damages; measure of damages; destruction or loss of property.

[4] The value of the subject helicopter is determined by its market value at the time of its destruction.

United States ⚖142

Contracts; damages; measure of damages; destruction or loss of property; insurance policy valuation.

[5] The insurance policy valuation placed on property is merely evidence of the worth of the property at the time it was insured, not at the time it was damaged or destroyed.

United States ⚖142

Interest; claims against the United States; when allowable.

[6] Interest on a claim cannot be awarded against the Government in the absence of a statute or contract expressly providing therefor. 28 U.S.C. §2516.

United States ⚖110

John L. Langslet, attorney of record, for plaintiff. *Martin, Bischoff, Templeton & Biggs*, of counsel.

Anthony Thompson, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Donnie Hoover*, of counsel.

Before DAVIS, KASHIWA, and KUNZIG, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

This case comes before the court on cross-motions for summary judgment. Principally at issue is the interpretation of a "risk of loss" clause in a contract by which Western Helicopter Services, Inc. (Western) subleased a helicopter owned by S. W. Aircraft, Inc. (Aircraft) to the United States Department of Agriculture for use by the

Forest Service. We resolve the ambiguity in favor of plaintiffs (Western and Aircraft) and therefore, grant their motion for summary judgment.

Facts leading to this law suit start with the agreement of June 28, 1972 between the Forest Service and Western providing for rental by the Government of aircraft (including helicopters) for use in firefighting operations. Pursuant to this agreement, Western leased an Aircraft-owned Bell Helicopter to the Forest Service.

Thereafter, on June 21, 1973, while circling a suspected fire location, the helicopter crashed, caught fire and was destroyed. Prior to the crash, the helicopter was flying below five hundred (500) feet. A spotter plane was also circling above the fire, and the aerial observer in the plane (a Forest Service employee) was directing the helicopter to the fire at the time it crashed.

The helicopter was jointly insured by the owner (Aircraft), and Western. Subsequent to the crash, the insurance company, via the loan receipt method,[1] paid the plaintiffs its maximum liability under the policy, $38,000.[2] Plaintiffs filed this suit on February 10, 1975 seeking to recover the value of the helicopter from the Government pursuant to the "risk of loss" provision in the rental agreement.

Before addressing the merits of the case, we first consider a subsidiary matter: Defendant's "motion," in its brief, to strike Aircraft as a party plaintiff. Defendant argues that although Aircraft owned the helicopter, the fact that Aircraft is not a party to the contract between Western and the Government and the existence of the lease to Western prevents Aircraft from being a proper party to the suit. We do not find this argument persuasive. Not only was Aircraft the owner of the helicopter and, therefore, entitled, *qua* owner, to bring this action under *N.J. Steam Navigation Co.* v. *Merchants' Bank*, 47 U.S. (6

[1] Under this method of payment, the named insureds are not actually paid by the insurance company, but merely *lent* an amount "equal to its loss 'repayable only in the event and to the extent of any net recovery' in any legal action brought in furtherance of claims covered by the loan agreement." *Winston Brothers Co.* v. *United States*, 198 Ct.Cl. 37,42, 458 F.2d 49,51 (1972).

[2] The insured value which had been placed on the helicopter by Western, et al., was $40,000. However, there was a $2,000 deductible clause which accounts for plaintiffs receiving only $38,000.

How.) 343,380–81 (1848), but Aircraft is also a named insured on the insurance policy and entitled to bring this action due to the loan receipt payment of the insurance proceeds. *See* note 1, *supra.*

Turning to the merits, the Government urges two principal positions. First, it argues that since the insurance company paid plaintiffs for the helicopter, they have not been injured and, therefore, have no right to recover.[3] To support this position, defendant, citing *Winston Brothers Co.* v. *United States*, 198 Ct.Cl. 37, 458 F.2d 49 (1972), relies on the theory that because defendant (supposedly) paid the insurance premiums, it should have the benefit of the insurance proceeds.

Alternatively, the Government contends that the contract between Western and defendant placed the risk of loss on the Government *only* when the helicopter pilot was *specifically instructed* to fly within 500 feet of the terrain. As the pilot was not so directed, defendant continues, the risk of loss is on plaintiffs. The Government must only prevail on one issue in order to bar plaintiffs' recovery.

Plaintiffs counter, arguing initially that the Government is not absolved from liability due to insurance company payments to Western and Aircraft. This position is buttressed with two principal arguments denying that *Winston, supra,* supports defendant's position.

In response to defendant's interpretation of the risk of loss clause, plaintiffs contend the Government is liable for an accident occurring during a flight at less than 500 feet elevation when the pilot's actions (regardless of specific elevation instructions) were directed by an appropriate Government official. As the accident in this case occurred on a Government-directed flight below 500 feet in elevation, defendant should pay. Plaintiffs must prevail on both issues in order to recover.

We hold for plaintiffs. Their receipt of the insurance proceeds does not bar this action. Under the lease

[3] As a corollary to this position, defendant argues that plaintiffs have been damaged only to the extent of the $2,000 deductible and if found liable, this should be the award of damages. *See* note 2, *supra.* As we decide, *infra,* that plaintiffs' receipt of the insurance proceeds does not bar this suit, this argument deserves no further mention.

agreement, defendant assumed liability for accidents occurring on Government-directed observation or scouting flights when the helicopter was at less than 500 feet elevation.

Insurance Proceeds

Defendant's first position, that payment of insurance proceeds to plaintiffs bars this suit, is based on the supposition that the Government automatically gains the benefit of any general insurance carried by a contractor when the cost of that insurance is paid by the Government. Defendant cites *Winston, supra,* as support. Plaintiffs, however, argue that *Winston* does not apply.

Winston involved a claim by a contractor against the Government for the recovery of the cost of drilling equipment destroyed by a tunnel cave-in. In *Winston,* the contractor was paid by its insurance company via the loan receipt method pursuant to a general insurance policy, the premiums of which had been paid by the Government. The contractor, however, sought recovery from the Government on breach of warranty and equitable adjustment grounds arguing that faulty Government-provided specifications caused the cave-in (and the damage). The court refused to hold the Government liable. It reasoned that since the contract placed the risk of loss on the contractor and the Government had paid insurance premiums for insurance covering the type of accident involved, then the Government should receive the benefit of the insurance proceeds.

The case at bar is distinguishable from *Winston* in two important ways. First, the Government did *not* pay for insurance to protect it against liability resulting from helicopter crashes occurring on Government-directed observation or scouting flights at under 500 feet in elevation. The affidavit of the underwriter who prepared the insurance policy (uncontroverted by counter affidavit from defendant) states that the cost of the insurance was less

> because of the government's contractual agreement to assume the risk of loss during scouting flights at less than 500 ft. If that provision had not been in the rental

agreement . . ., the cost of the insurance would have been higher.

Second, in this case, unlike *Winston*, the *Government agreed to pay* for losses incurred due to accidents on Government-directed observation or scouting flights at less than 500 feet in elevation. *See infra*, "Risk of Loss." Since the Government assumed the risk of loss and did not pay premiums to cover insurance for this type of accident, there is no reason to give the Government the benefit of the insurance proceeds.[4] *Winston, supra*, 198 Ct.Cl. at 46, 458 F.2d at 54.

Thus, *Winston* is inapposite; the Government did not pay for insurance covering this type of helicopter accident; plaintiffs' receipt of insurance proceeds does not bar this suit; and defendant's lead argument fails.

Risk of Loss

We come now to the basic issue of the case. What *exactly* does the following provision of the rental agreement mean?

> *LOSS, DAMAGE, OR DESTRUCTION OF CONTRACTOR'S EQUIPMENT*
> Loss, damage, or destruction of the Contractor's equipment will be borne by the Contractor, except where caused solely by the negligent acts of Government employees or where the loss, damage, or destruction happens without fault of either the Government or the Contractor under the following conditions:
>
> 1. *During flights at elevations within less than 500 feet of the terrain for the purpose of observation or scouting, when directed by the Supervising Officer or by the Forest Officer making the flight.* (emphasis supplied)

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[4] We note that in addition to placing the risk of loss on the Government for the type of accident that occurred, the contract does not mention insurance with regard to helicopter accidents. However, the rental agreement *does specify* that insurance against workmen's compensation and/or workmen's liability claims inures to the Government's benefit. This illustrates that the Government knew how to protect itself against possible claims. Its silence regarding helicopter crashes (especially when helicopters are recognized as one of the most dangerous of normally-used aircraft), paradoxically speaks loudly to the effect that the Government never intended the insurance coverage in issue here to be for its benefit.

Defendant would have us say that the Government assumes the risk only when the helicopter is specifically directed below 500 feet. Plaintiffs, of course, argue that the Government bears the responsibility whenever an accident occurs when the helicopter is flying below 500 feet, even absent specific altitude instructions, if the flight itself is Government-directed.

Basically our task is one of contract interpretation. The provision sets out three requirements which must be met in order to fix liability. The first two are stipulated by the parties: First, that the accident was the fault of neither the Government nor Western. Second, that the accident occurred while the helicopter was flying within "500 feet of the terrain for the purpose of observation or scouting."

It is the third requirement, the degree of Forest Service direction, that is in issue.

The parties stipulate that:

> "At the time the helicopter crashed, it was being directed to the site of the fire by Mr. Ty Wood, a United States Forest Service aerial observer (who was a summer employee), but the helicopter was not instructed to fly at any specific altitude."

The question, therefore, is whether Mr. Wood's directions are sufficient under the contract to make the Government liable.

We think they are. Ordinarily in interpreting a contract or statute, we look to the plain meaning of the provision in question. *Selman* v. *United States*, 204 Ct.Cl. 675,680, 498 F.2d 1354,1356 (1974); *Guarriello* v. *United States*, 201 Ct.Cl. 129,134, 475 F.2d 640,642 (1973); *Hotpoint Co.* v. *United States*, 127 Ct.Cl. 402, 117 F.Supp. 572, *cert. denied*, 348 U.S. 820 (1954). But in the instant case, the words are susceptible of two meanings.

Defendant asks us to examine various Federal regulations pertaining to aircraft operations. Specifically, the Government argues that, as Federal regulations (14 C.F.R. § 91.79 (1976)) provide that 500 feet is the minimum safe altitude at which all aircraft may be operated, the contract should be read as making the Government liable only when the pilot is specifically ordered below 500 feet in altitude.

However, 14 C.F.R. § 91.79(d) carves out an exception from the 500 feet limit for *helicopters*, stating:

> Helicopters may be operated at less than the [500 feet] minimum . . . if the operation is conducted without hazard to persons or property on the surface. 14 C.F.R. § 91.79(d) (1976).

The concern in the regulation is not for the safety of the helicopter when operating at less than 500 feet, but for the safety of persons and property *on the ground*. In the instant case, the helicopter did not pose a hazard within the meaning of the regulation as it was operating over an uninhabited part of Mt. Hood National Forest. So the regulation does not support the Government's position,[5] but rather returns the risk of loss question to the court for determination.

What remains is a problem of draftsmanship—a classic example of the misplaced modifier. In such a case, we are influenced greatly by the fact that the Government drafted the contract. It had the opportunity to make the provision clear, but it did not. Applying the rule of *contra proferentem*,[6] we hold that the clause should be construed against the drafter, the Government.

Under this interpretation, it is clear that the contractual provision does not require that the pilot be specifically instructed to fly at less than 500 feet in altitude. It only requires that, for the Government to be liable, the helicopter be flying at under 500 feet and following the instructions of defendant's aerial observer.

That is exactly what occurred in this case. At the time of the crash, the pilot was operating the helicopter at less than 500 feet and was under the constant direction of the Forest Service aerial observer in a spotter plane flying at a higher altitude than the helicopter. The Government, therefore, must bear the cost of the destruction of the helicopter.

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[5] If this suit were a suit to determine who would pay for property damaged on the ground as a result of the crash (besides the helicopter and occupants), the regulation might be of assistance. But that is not this case.

[6] *See Consumers Ice Company* v. *United States*, 201 Ct.Cl. 116,123, 475 F.2d 1161,1165 (1973); *Chris Berg, Inc.* v. *United States*, 197 Ct.Cl. 503, 455 F.2d 1037 (1972); *Mountain Home Contractors* v. *United States*, 192 Ct.Cl. 16, 425 F.2d 1260 (1970); *WPC Enterprises, Inc.* v. *United States*, 163 Ct.Cl. 1, 323 F.2d 874 (1963).

The question remains, however, as to the amount of damage for which the Government is liable. Plaintiffs request $42,000, the market value of the helicopter at the time of its destruction, plus interest of six percent (6%) per annum from the date of destruction, June 21, 1973. To show the market value, plaintiffs rely on the affidavit of Mr. Stu White, Aircraft's president at the time of the crash, but—at the time of the affidavit—regional marketing manager for Bell Helicopters.

Defendant responds by contending that the value for which the helicopter was insured, $40,000, is the proper valuation. In addition, defendant claims Mr. White's affidavit should not be accorded weight for it does not comply with Ct.Cl. Rule 101(f) that the affidavit show affirmatively that the affiant is competent to testify to the matters stated therein. Defendant, however, does not challenge the plaintiffs' affidavit with one of its own.

Plaintiffs are correct in part; the value of the helicopter is determined by its market value at the time of the accident. *H. K. Porter Co., Inc.* v. *Halperin*, 297 F.2d 442,445 (7th Cir. 1961); *John W. Hubbard* v. *United States*, 92 Ct.Cl. 381,386 (1940). The value of the insurance policy is merely evidence of the worth of the helicopter at the time it was insured, not at the time it crashed. The affidavit, regardless of defendant's contention, does show the affiant's competence in accordance with Ct.Cl. Rule 101(f). Mr. White is the regional representative for Bell Helicopters; he has bought and sold numerous helicopters. Both the destroyed helicopter and its replacement were the same model of Bell helicopter.

Mr. White stated that the market value of the destroyed helicopter at the time of the accident was between $42,000 and $45,000. Plaintiffs claim the lower limit, $42,000, even though the replacement helicopter cost $45,000 and was "not quite as nice as the one which was destroyed." We think plaintiffs' evidence is sufficient for the court to fix

Syllabus

the market value of the helicopter at the time of the accident at $42,000, and so hold.[7]

However, plaintiffs' additional claim for interest is not meritorious. 28 U.S.C. § 2516 (1970) provides that interest on a claim against the United States shall be allowed "only under a contract or Act of Congress expressly providing for payment thereof." This statute is strictly applied. *Komatsu Mfg. Co.* v. *United States*, 132 Ct.Cl. 314, 131 F.Supp. 949 (1955). As we can find no Act of Congress which provides for interest in this case (nor has any been cited to us by plaintiffs), and the contract is silent on this point, plaintiffs' claim for interest is denied.

In summary, plaintiffs are not barred from prosecuting this suit due to their receipt of the insurance proceeds; defendant is liable for the destruction of the helicopter under the contract; and plaintiffs are entitled to damages in the amount of $42,000.00, without interest.

Accordingly, defendant's motion for summary judgment is denied, plaintiffs' cross-motion for summary judgment is granted and judgment is hereby entered for plaintiffs in the amount of $42,000.00.

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551 F.2d 821

EMMETT E. NORTON and FRANCIS G. NORTON v. THE UNITED STATES

[No. 31–75. Decided March 23, 1977. Plaintiffs' suggestion for rehearing *en banc* and motion for rehearing denied April 29, 1977]*

ON PLAINTIFFS' AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; income tax; capital gain v. ordinary income; sale of contract rights; timber cutting contract.—In January 1968 plaintiff entered

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[7] We note, contrary to defendant's contention, that our holding does not grant plaintiffs a "windfall" of $42,000. Defendant's argument on this point, as mentioned *supra*, is based on the theory that plaintiffs, if allowed to recover, will be left with both the insurance recovery *and* the award from this court. That is not the situation; the insurance proceeds will be returned to the insurance company leaving plaintiffs with only the award of this court. *See* note 1, *supra*. The return of the money is required by the insurance policy (Clause 17). This obligation was reaffirmed by plaintiffs in their briefs and again in open court by plaintiffs' counsel.

* On June 9, 1977 plaintiffs filed a petition for a writ of certiorari.

Syllabus

into a contract for timber cutting in the South Tongass National Forest (the Turn Point contract) with the United States Forest Service (FS). The contract provided that FS agreed to sell and permit Norton to cut, and Norton agreed to purchase and cut, included timber. All right, title and interest in and to any included timber subject to said contract remained in FS until it was cut, scaled and paid for, whereupon title vested in Norton who then had to remove the timber from the area. During 1968 and until March 19, 1969 plaintiff's sole business was the cutting of the Turn Point contract standing timber and its sale to unrelated Ketchikan Pulp Co. In March 1969 plaintiff sold his Turn Point timber cutting rights to Ketchikan; thereafter plaintiff ceased logging operations. In their 1969 income tax return plaintiffs elected to report the gain realized from the sale to Ketchikan on the installment basis; and in their returns for 1969, 1970 and 1971 they reported 94.2% of the amount received from Ketchikan as long-term capital gains. The IRS determined that said gains should have been reported as ordinary income, and noticed plaintiffs of the deficiency. Plaintiffs were unable to pay within the statutory 10 days due to lack of funds; later the deficiency, including penalty, was paid. Since plaintiffs' refund claims had not been acted upon within 6 months of filing, they instituted the present suit. Plaintiffs contend that the Turn Point contract was a capital asset or, alternatively, that their interest in the contract and underlying timber was real property used in their trade or business within the meaning of Sec. 1231(b)(1) of the Code, qualifying them for long-term capital gain. They also seek refund of the late-payment penalty, asserting that failure to timely pay the deficiency was due to reasonable cause and not to willful neglect. For the reasons stated, it is held (1) that plaintiff's interest in the Turn Point contract was not real property used in his trade or business within the purview of Sec. 1231(b)(1); (2) that the gain realized from the sale of said contract was ordinary income within the rationale of *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46 (1955); and (3) that the addition to the tax as provided under Sec. 6651(a)(3) was appropriate, plaintiffs having failed to show that failure to pay the deficiency within the 10 days was due to reasonable cause. Plaintiffs' motion for summary judgment is denied, defendant's cross-motion is granted and the petition is dismissed.

Taxes; income tax; capital gains and losses; property used in trade or business; what constitutes.

[1] To constitute real property used in the trade or business within the meaning of Sec. 1231(b)(1) of the Code, taxpayer must have acquired a present interest in the realty (standing timber) on execution of the subject contract. Thus, where the contract gave taxpayer the right to purchase and cut timber, but provided that until it was cut and paid for title thereto remained in the seller, this is an indication that the parties did not intend to transfer a present interest in the standing timber, and accordingly taxpayer's interest in the contract was not real property used in his trade or business.

Internal Revenue ⚖409.3

Taxes; income tax; capital gains and losses; property used in trade or business; what constitutes.

[2] Where taxpayer entered into a sales contract obligating him to buy a specific amount of timber, whether cut or not, within a period of approximately 3 years, since the contract was not an asset which diminished in value with use or passage of time and since it had neither a basis nor a useful life, the contract was not of a character subject to allowance for depreciation and, accordingly, cannot be considered property used in taxpayer's trade or business within the definition of Sec. 1231(b)(1).

Internal Revenue ⚖409.3

Taxes; income tax; capital gain v. ordinary income; sale of contract rights; timber cutting contract.

[3] Where the subject contract gave taxpayer who was in the logging business the right to purchase and cut standing timber after which he sold the cut timber to a third party, since the contract was acquired by taxpayer with an intention that it would serve an integral function in his regular business activities and that motive had not changed when he sold all of his contract timber cutting rights, under the doctrine of *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955), gain on the sale of the contract was a part of taxpayer's ordinary business income and taxable as such.

Internal Revenue ⚖409.3

Taxes; penalties; failure to pay tax; reasonable cause.

[4] Reasonable cause for failure to pay a tax exists to the extent that taxpayer can satisfactorily show that he exercised ordinary business care and prudence in providing for payment of his liability, but was, nevertheless, either unable to pay the tax or would have suffered undue hardship if he paid on the due date. It is taxpayer's burden to prove failure to pay was due to reasonable cause and not to willful neglect, and absent an excuse the court will sustain the penalty imposed by the Internal Revenue Service.

Internal Revenue ⚖2364, 236.1

Charles P. Duffy, attorney of record, for plaintiff. *Duffy, Stout, Georgeson & Dahl*, of counsel.

C. Patrick Derdenger, with whom was *Acting Assistant Attorney General Myron C. Baum*, for defendant. *Theodore D. Peyser*, of counsel.

Before DAVIS, KASHIWA and KUNZIG, *Judges*.

KASHIWA, *Judge*, delivered the opinion of the court:

This tax refund action involving the characterization of gain realized by plaintiffs from their sale of a timber

cutting contract is before the court on cross motions for summary judgment. The facts essential to the disposition of the case are not in dispute. For the reasons set forth below, we agree with the defendant that the gain realized by the plaintiffs does not qualify as gain from the sale of a capital asset. We, therefore, allow defendant's cross motion for summary judgment.

Plaintiff,[1] Emmett E. Norton, an individual doing business as the Norton Logging Company, on January 30, 1968, entered into a timber cutting contract[2] with the United States Forest Service (hereinafter referred to as the Turn Point contract). The Turn Point contract specified:

> In consideration of the premises and the promises hereinafter contained, Forest Service agrees to sell and permit Purchaser to cut and Purchaser agrees to purchase and cut included Timber.

All right, title and interest in and to any included timber in the Turn Point contract remained in the Forest Service until it had been cut, scaled and paid for; at that time, title vested in the plaintiff who then had to remove the processed timber from the contract sales area within the period of the contract. All losses, except for negligence, were to be borne by the party holding title.

Throughout the remainder of 1968 and until March 19, 1969, plaintiff was engaged in the logging business. This entailed both the cutting of the standing timber located in the South Tongass National Forest subject to the Turn Point contract and the selling of the logs to Ketchikan Pulp Company (hereinafter referred to as Ketchikan), an unrelated Washington corporation. The plaintiff did not operate a sawmill nor was he engaged in manufacturing lumber, veneer or other wood products. His sole activity was the cutting of the standing timber and its sale to Ketchikan.

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[1] Frances G. Norton is a party to this action only because she filed joint returns with her husband, Emmett E. Norton, for the years in question. Where reference is made to Mr. Norton acting individually, he will be referred to as the "plaintiff"; where reference is made to both Mr. and Mrs. Norton, they will be referred to as the "plaintiffs."

[2] United States Department of Agriculture Forest Service Timber Sale Contract No. 05–92. The contract relates to certain designated timber in the South Tongass National Forest, State of Alaska.

As the standing timber was cut and scaled, the plaintiff was required to pay the Forest Service under the terms of the contract $9.05 per thousand board feet for Sitka Spruce and $2.32 per thousand board feet for Western Hemlock and other species. To insure the performance of his obligation under the Turn Point contract, the plaintiff executed a performance bond in the amount of $5,000. During the period January 30, 1968, through March 19, 1969, the plaintiff logged 9,919,040 board feet of the estimated 30,000,000 board feet of timber subject to the contract.

On March 19, 1969, 13½ months after the plaintiff entered into the Turn Point contract, he sold all of the timber cutting rights under the contract to Ketchikan for the sum of $127,500,[3] with no interest thereon, payable at the rate of $8.50 per thousand board feet of logs produced. In connection with the transaction, Ketchikan executed a promissory note which recites that Ketchikan will pay the plaintiff the $127,500, regardless of an over-run or under-run of the volume of timber under the Turn Point contract.[4]

Prior to the March 19, 1969, sale to Ketchikan, the plaintiff had neither sold nor held for sale a Government timber contract. After that sale, the plaintiff ceased independent logging operations entirely and sold all logging equipment, machinery and supplies to Ketchikan.

In filing their joint federal income tax return for the year 1969, the plaintiffs elected to report the gain realized from the sale of the timber cutting rights to Ketchikan on the installment basis pursuant to § 453.[5] Their tax basis for determining gain or loss was $7,400,[6] with a resulting 94.2

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[3] Even though the bill of sale specified that both the Turn Point contract and various pieces of logging equipment were sold for $127,500, the Norton affidavit makes it clear that the $127,500 was the purchase price of the timber cutting rights alone.

[4] Since the total purchase price was not dependent upon the amount of timber cut, plaintiff concedes that he did not retain an economic interest in the timber transferred to Ketchikan within the meaning of I.R.C. § 631(b). Therefore, I.R.C. § 1231(b)(2) is not applicable to the instant case.

[5] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954.

[6] Plaintiffs' tax basis is the sum of a $5,000 cash bond and a $2,400 advance stumpage deposit with the Forest Service.

percent of gain. On their income tax returns for the years 1969, 1970 and 1971, the plaintiffs reported 94.2 percent of the amount received from Ketchikan as long-term capital gains.

Upon audit of plaintiffs' tax returns, the Commissioner of the Internal Revenue Service (Commissioner) determined that the gain recognized by plaintiffs in 1969, 1970 and 1971, attributable to the sale of the Turn Point contract to Ketchikan, should have been reported as ordinary income rather than as long-term capital gain. A statutory notice of deficiency for 1969 through 1971 was issued by the Commissioner on March 20, 1973. Thereafter, plaintiffs received billings for the deficiency, which they were unable to pay within 10 days because of lack of funds.

On November 21, 1973, the plaintiffs paid $8,000 to the District Director, Anchorage, Alaska. On January 21, 1974, the Division of Veterans Affairs of the Department of Commerce of the State of Alaska paid, on the plaintiffs' behalf, the remaining sum of $10,999.48 from the proceeds of a loan.[7]

Plaintiffs filed with the Internal Revenue Service (IRS) Center at Ogden, Utah, their timely refund claims for the years 1969 through 1971. The IRS not having acted upon their refund claims for more than 6 months after the date of filing, the plaintiffs filed a petition in this court based upon the same grounds as set forth in the refund claims.

Plaintiffs argue that the timber cutting contract involved herein was a capital asset, or in the alternative, plaintiff's interest in the contract and underlying timber was "real property used in the trade or business" of plaintiff within the meaning of § 1231(b)(1). Under either alternative, plaintiffs contend that the gain realized on the sale of the contract qualifies as long-term capital gain since the contract was held by plaintiff for more than six months. Nevertheless, plaintiffs concede that a portion of the payments received by them on the sale of the Turn Point contract should be imputed interest, taxable as ordinary

[7] Payments totaling $18,999.48 were received by the Internal Revenue Service; $5,468.81 was allocated to plaintiffs' 1969 tax year; $6,290.58 was allocated to plaintiffs' 1970 tax year; and $7,240.09 was allocated to plaintiffs' 1971 tax year.

income.[8] Lastly, plaintiffs seek refund of the additions to the tax, "late-payment penalties," which they argue should not have been exacted from them since their failure to pay the deficiencies within ten days of the date of the first notice and demand therefor was due to reasonable cause—inability to pay or undue hardship—and not due to willful neglect within the purview of § 6651(a)(3).

On the other hand, defendant contends that the gain realized by plaintiffs from the sale of the Turn Point contract does not qualify for capital gain treatment. Initially, the defendant submits that plaintiff's interest in the Turn Point contract and the underlying timber was real property used in plaintiff's trade or business; it must be treated as a noncapital asset by virtue of § 1221(2), but is precluded from § 1231(a) treatment by the *Corn Products*[9] doctrine since the contract was an integral part of the plaintiff's business. Alternatively, defendant argues that the *Corn Products* doctrine would exclude plaintiff's contract from § 1221. Defendant has failed, however, to address the plaintiffs' last contention that their failure to pay the deficiencies within ten days of the date of the first notice and demand therefor was due to reasonable cause.

We are faced with the preliminary issue of whether plaintiff's interest in the Turn Point contract would qualify either as a § 1221 asset or as a § 1231(b)(1) asset, but for the *Corn Products* doctrine. Of necessity, we then must examine the *Corn Products* doctrine to determine its applicability to the instant case.

Defendant contends and the plaintiffs submit as an alternative argument that plaintiff's interest in the Turn Point contract and underlying timber was real property used in the plaintiff's trade or business. We find these contentions lack merit. To constitute realty plaintiff must have acquired a present interest in the standing timber on the execution of the contract. The facts before us do not

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[8] I.R.C. § 483; Treas. Reg. § 1.483–1(c)(2), T.D. 6873, 1966–1 C.B. 101. In the case of an installment contract which does not contain any provision for interest, the amount of interest to be imputed is computed at the rate of 5 percent per annum compounded semiannually. Although not applicable to the instant case, it should be noted that T.D. 6873 was amended by T.D. 7394, 1976–1 C.B. 135.

[9] *Corn Products Refining Co.* v. *Comm'r*, 350 U. S. 46 (1955).

demonstrate that the parties to the contract intended to transfer a present interest in the standing timber. As we earlier recapitulated, the contract gave plaintiff the right to purchase and cut timber; however, until cut and paid for, the title to that timber remained in the seller. This indicates an intent that no present interest in real property, the standing timber, passed to the plaintiff. We have considered our decision in *Barclay* v. *United States*,[10] in addition to *United States* v. *Giustina*,[11] which decisions, while interpreting similar timber cutting sales contracts with relation to the word "owner" in § 117(k)(2) of the 1939 Code [now § 631(b) of the 1954 Code], held that such contracts gave the holder beneficial ownership of all the timber on the tract.[12] To the defendant, the fact that plaintiff had beneficial ownership in the timber is sufficient to make the timber cutting contract real property. Defendant reasons that standing timber is real property; therefore, a timber cutting contract which gives beneficial ownership in standing timber is real property. With this reasoning we cannot agree. The above cases define owner status for § 117(k)(2) of the 1939 Code purposes; they do not determine that the timber contract there in issue is real property. In fact, this court in *Barclay*[13] refused to consider whether the timber contract there in issue qualified for § 117(a) of the 1939 Code [now §§ 1221 and 1222 of the 1954 Code] which thereby obviated the need to determine whether the contract was real property used in the taxpayer's trade or business. Since we are convinced that on the facts before us the parties did not intend to transfer a present interest in the standing timber, we hold that plaintiff's interest in the Turn Point contract was not real property used in his trade or business. It should be noted that our decision is compatible with the Tax Court's decision in *J. R. Simplot Co.* v. *Commissioner*,[14] which held

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[10] 166 Ct. Cl. 421, 333 F. 2d 847 (1964). *See also Union Bag-Camp Paper Corp.*, 163 Ct. Cl. 525, 325 F. 2d 730 (1963).

[11] 313 F. 2d 710 (9th Cir. 1962).

[12] *See also* Treas. Reg. § 1.631–2(e)(2) (1960) and Rev. Rul. 58–295, 1958–1 C.B. 249.

[13] 166 Ct. Cl. at 427, 333 F. 2d at 851.

[14] 26 T.C.M. (CCH) 488 (1967).

that a similar contract was insufficient to transfer a present interest in the standing timber.

To disqualify the Turn Point contract from § 1231(b)(1), we must also determine that it was not "property used in the trade or business of a character which is subject to the allowance for depreciation provided in section 167." Given the nature of the contract, this task is not difficult. The Turn Point contract was merely a sales contract obligating the plaintiff to purchase a specific amount of timber—whether cut or not—within a period of approximately three years.[15] Nonetheless, the contract was not the type asset which diminished in value with use or passage of time and it had neither a basis nor a useful life; consequently, it was not of a character subject to the allowance for depreciation. We, therefore, hold that the Turn Point contract was not property used in the plaintiff's trade or business within the definition of § 1231(b)(1). However, we do not agree with the plaintiffs who submit that the contract is a § 1221 asset.

The plaintiffs argue that they sold the Turn Point contract, itself, rather than the timber which was the subject of that contract. They assert that the contract was "property" which did not fall into any of the specified exclusions of § 1221 and, therefore, the contract is a capital asset, the sale of which gave rise to capital gain. The plaintiffs also rely upon *Commissioner* v. *Ferrer*,[16] for the proposition that a contract is a capital asset if the contract rights created an equitable interest in specific property which was itself a capital asset. By arguing that the contract gave plaintiff an equitable interest in the timber subject to the contract, citing *Barclay* v. *United States*, *supra*, the plaintiffs reason that they sold a capital asset. We disagree.

With respect to the treatment of amounts received on the sale of contract rights, courts have approached in numerous ways the question of whether the property disposed of was the type of property that Congress intended to

[15] The contract was awarded on January 30, 1968, and was to terminate on December 31, 1970.

[16] 304 F. 2d 125 (2d Cir. 1962).

classify as a capital asset.[17] Plaintiffs point to the approach utilized in *Ferrer* to support their argument. In *Ferrer*, Judge Friendly summarized the immense body of decisional law in the assignment of income area and wrestled with the various complex issues that can arise from the basic question of whether a taxpayer has transferred a "property" right or an "income" right. Rather than utilize this approach, we feel that the instant case can be decided under the *Corn Products* doctrine exception to the statutory syllogism that all property is a capital asset unless specifically excluded by the exceptions in § 1221.

The Supreme Court has stated that the sale of property, though not literally within the exceptions of § 1221, may nevertheless give rise to ordinary income or loss when the asset is an integral part of the taxpayer's business. *Corn Products Refining Co.* v. *Commissioner, supra* note 9. The application of the *Corn Products* doctrine to the instant case seems clear to us. The plaintiff was engaged in the logging business: cutting standing timber and selling the cut timber to Ketchikan. The Turn Point contract gave the plaintiff the right to cut timber; it insured the plaintiff a ready source of supply of the logging business raw material, timber. The contract, therefore, was essential to and an integral part of plaintiff's logging business. The contract gave plaintiff rights in the timber which were so integrally related to his ordinary business objectives of logging the timber that a "business use" intention rather than an "investment" intent prevailed.[18] In other words, the contract was acquired by plaintiff with an intention

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[17] Eustice, *Contract Rights, Capital Gain, and Assignment of Income—the Ferrer Case*, 20 Tax L. Rev. 1 (1964). The approaches may be grouped into certain broad categories: (1) Is the asset "property" which is a "capital asset" under § 1221? *See Comm'r* v. *Gillette Motor Transport Co.*, 364 U. S. 130 (1960); *Comm'r* v. *Ferrer, supra* note 16. (2) Do the amounts received by the taxpayer upon the sale of the contract rights represent a substitute for future ordinary income that would otherwise have been received by the taxpayer? *See Comm'r* v. *P. G. Lake Inc.*, 356 U. S. 260 (1958); *Comm'r* v. *Ferrer, supra*. (3) Does the transaction constitute a "sale or exchange"? *See Fairbanks* v. *United States*, 306 U. S. 436 (1939). (4) Was the property acquired with an intention that it would serve an integral function in the taxpayer's regular business activities? *See Corn Products Refining Co.* v. *Comm'r, supra* note 9.

[18] However, it should be noted that our approach here does not serve to read out of the statute the obvious and important class of "business connected" assets covered by § 1231.

that it would serve an integral function in his regular business activities and that motive had not changed at the time of sale. Under the *Corn Products* doctrine, gain on the sale of that contract is, therefore, part of plaintiff's ordinary business income. We are not persuaded otherwise by plaintiffs' argument that since the sale of the Turn Point contract represents the concluding phase of liquidating the logging business, the *Corn Products* doctrine should not be applied.[19]

Since we hold that the gain realized by the plaintiffs from the sale of the Turn Point contract was ordinary income within the rationale of the *Corn Products* doctrine, we need not consider the applicability of § 483 to the instant case.[20] However, we must address plaintiffs' argument that the additions to the tax, as provided under § 6651(a)(3), should not have been exacted from them. Plaintiffs argue that their failure to pay the deficiencies within ten days of the date of the first notice and demand therefor was due to their inability to pay which to them was reasonable cause, not willful neglect.

Reasonable cause for failure to pay tax exists to the extent the taxpayer can satisfactorily show that he exercised ordinary business care and prudence in providing for the payment of his liability, but was, nevertheless, either unable to pay the tax or would have suffered "undue hardship"[21] if he paid on the due date.[22] The burden of proving that the failure to pay was due to reasonable cause and not to willful neglect is on the taxpayer. If the taxpayer offers no excuse, the penalty will be sustained by the court.[23]

In the instant case, plaintiffs have failed to introduce any evidence to show that their failure to pay the tax was

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[19] *See J. R. Simplot Co.* v. *Comm'r*, 26 T.C.M. (CCH) at 492. *Cf. Hollywood Baseball Ass'n* v. *Comm'r*, 423 F. 2d 494, 499–500 (9th Cir.), *cert. denied*, 400 U. S. 848 (1970) (*Corn Products* doctrine applied to § 337).

[20] I.R.C. § 483(f)(3).

[21] Undue hardship has the same meaning for § 6651(a)(3) purposes as it does under § 6161, extensions of time to pay tax, Treas. Reg. § 1.6161–1(b) (1960).

[22] Treas. Reg. § 301.6651–1(c)(1), T.D. 7133, 1971–2 C.B. 415.

[23] *Deffendall* v. *United States*, 386 F. Supp. 509, 512 (D. Or. 1974); *Fischer* v. *Comm'r*, 50 T.C. 164, 177 (1968). *Cf. Olshausen* v. *Comm'r*, 273 F. 2d 23 (9th Cir. 1959), *cert. denied*, 363 U. S. 820 (1960) (I.R.C. § 294 of the 1939 Code, burden to prove reasonable cause on the taxpayer).

due to reasonable cause. We must, therefore, sustain the § 6651(a)(3) addition to the tax.

CONCLUSION

For the reasons hereinbefore stated, plaintiffs' motion for summary judgment is denied, defendant's cross motion for summary judgment is granted and plaintiffs' petition is dismissed.

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551 F.2d 827

O. L. GRAGG AND INEZ GRAGG v. THE UNITED STATES

[No. 176–74. Decided March 23, 1977]

OPINION

Taxes; income tax; capital gains and losses; gain from disposition of property used in farming; constitutionality of Sec. 1251 of the Internal Revenue Code.—Plaintiffs are ranchers, the raising and selling of breeding cattle being a part of their activities. In 1970 plaintiffs sold 1,696 yearlings as breeding cattle, paying the tax on the proceeds computed at long-term capital gains rates as property used in their trade or business under Sec. 1231(b)(3) of the Code. The Internal Revenue Service imposed an additional tax, based on application of Sec. 1251 to plaintiffs' farm gains and previous farm losses. Sec. 1251 restricts the availability of capital gains treatment for the proceeds of livestock sales. Plaintiffs filed a timely refund claim, asserting that the statute is unconstitutional because the sixteenth amendment precludes the statute's attempt to disregard the gains from the disposition of farm property from the special computation of gross income in Subsec. (B) of Sec. 1251(e)(2) for the purpose of determining farm net loss. Upon disallowance of their claim, plaintiffs filed the present suit seeking recovery of the deficiency assessment plus interest. The trial judge, without considering the constitutional issue, resolved the case by denying capital gains treatment on the ground that the sales represented sales of property held for sale to customers in the ordinary course of plaintiffs' trade or business, and therefore gains realized on the sales should be treated as ordinary income. However, the court deemed it necessary to address plaintiffs' constitutional contention. Accepting plaintiffs' premise that Congress excluded gains from the sale of livestock from income, it is *held* that such action was not unconstitutional in view of the broad powers granted Congress by the sixteenth amendment and the legislative aim to correct opportunities

for abuse by restricting availability of capital gains treatment for the proceeds of livestock sales. Congress has not excluded any income from taxation - its intent was the opposite, to increase plaintiffs' tax burden, not to diminish it, and it chose to do so by taxing more of their income not less. Plaintiffs are not entitled to recover and the petition is dismissed.

Constitutional law; Congress, powers of; taxation–Sixteenth Amendment; "income".

[1] The sixteenth amendment supports a broad construction of the taxing power, whenever Congress chooses to exercise the full measure of its powers. Under such powers, Congress may classify income depending on its source, and exclude from gross income some of the varieties it has identified.

Internal Revenue ⚖3,301

Taxes; income tax; capital gains and losses; gain from disposition of property used in farming where farm losses offset nonfarm income; farm net loss.

[2] In enacting Sec. 1251(e)(2)(B) of the Internal Revenue Code, Congress, within its broad power to lay and collect taxes on income, has chosen to exclude gains from the sale of business assets, such as livestock, from gross income for purpose of determining "farm net loss." The purpose of the legislation was to avoid abuse of the taxing statute by restricting the availability of capital gains treatment for the proceeds of livestock sales, a purpose within Congress' constitutional powers. This provision does not violate the sixteenth amendment and is not inconsistent with Sec. 61(a) of the Code defining "gross income."

Internal Revenue ⚖31

Harold A. Chamberlain, attorney of record, for plaintiff. *Chamberlain, Hrdlicka, White & Waters*, of counsel.

Allan C. Lewis, with whom was *Acting Assistant Attorney General Myron C. Baum*, for defendant. *Theodore C. Peyser* and *Donald H. Olson*, of counsel.

Before COWEN, *Senior Judge*, NICHOLS and BENNETT, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

In this tax refund case, plaintiffs urge us to hold that § 1251 of the Internal Revenue Code is constitutionally invalid because in computing a taxpayer's "farm net income" § 1251(e)(2)(B) excludes some gains from calculation of gross income that could otherwise be considered taxable "income" under the sixteenth amendment. Thus,

according to plaintiffs Congress has arbitrarily denied these gains their character as income, which plaintiffs contend is constitutionally mandated. For the reasons set forth below, we reject plaintiffs' theory, we hold for the Government and deny plaintiffs' claim for a refund of taxes paid.

The facts of the case are disarmingly straight-forward, especially in relation to the statutory law that applies to them. For many years, including taxable year 1970 which is the subject of this suit, plaintiffs maintained a large herd of breeding cattle incident to their ranching business. It was plaintiffs' practice each November to round up their entire herd, and to segregate their yearling cattle (*i.e.*, those over a year old) for closer observation, in order to evaluate their potential as future breeders. Yearlings that displayed physical characteristics that revealed to plaintiffs their good breeding potential were branded and considered a part of the breeding herd, to the extent needed to maintain the size and quality of that herd. Excess potential and branded breeders, along with other yearlings whose physical development was less desirable, were sold thereafter and not bred. The record shows that plaintiffs have sold yearlings in each year since 1960, at least, and that over the years, plaintiffs have acquired a reputation as suppliers of yearling cattle with good breeding potential. In 1970, plaintiffs sold 1,696 yearlings, which they had considered property used in their trade or business under § 1231(b)(3), as breeding cattle, and paid the tax on the proceeds as indicated for that amount of long-term capital gain, without regard to whether cattle were actually bred, but only with regard to whether they were branded. After auditing plaintiffs' tax return for 1970, defendant imposed upon them an additional tax, based on the application of § 1251 to plaintiffs' farm gains and previous farm losses.

Section 1251, added to the tax law as a part of the Tax Reform Act of 1969, Pub. L. 91–172, 83 Stat. 487, § 211(a), aims to prevent taxpayers engaged in farming from, in effect, converting their ordinary income into capital gains in order to qualify for a lower rate of tax. *See* U.S. Code Cong. & Admin. News 1708–14 (1969). The Congress had

determined, evidently, that the application of certain statutory accounting rules to farming operations afforded some taxpayers an unfair advantage from the law's comparatively lenient tax burden on capital gains. Such taxpayers could by express provision, § 1231(b) (3), treat livestock held for breeding, etc., purposes as property used in the trade or business, *i.e.*, taxable when sold at capital gains rates. They could deduct from their nonfarm ordinary income, as current expenses, costs of the kind that would be capital in nature for taxpayers engaged in other businesses, for example the expenses of a breeding herd of livestock. See Treas. Reg. § 1.61–4, permitting farmers to apply the "cash method" of accounting to such activities. A typical business taxpayer would have to capitalize the expenses incurred, thus reducing the capital gains to be realized upon the eventual disposition of the asset, but causing no direct reduction of the taxpayer's current tax liability. One who raises breeding livestock, however, may deduct as current expenses all of the costs incurred in raising the herd, plus depreciation. When the animals are later sold, although the gains realized cannot be reduced because the expenses incurred have already been recovered out of current income, the lower rate of tax imposed on capital gains generally represents a significant tax benefit to the taxpayer involved in farming. The advantage is magnified as a taxpayer enters the higher income brackets. That taxpayer could, in effect, elect to pay a lower tax upon his capital gains in order to avoid a higher rate of tax on his ordinary income during the years he held the assets.

Plaintiffs' tax returns for the years 1965–69 reveal how beneficial this system was for them, in practice. With respect to their ranching business done during these years, the plaintiffs were cash-basis taxpayers who, as such, were allowed to deduct currently all the labor, feed, and other expenses incident to raising their breeding herd. From 1965 to 1969, plaintiffs reported gross farm income of $157,319.10, but their accumulated expenses of $948,897.81 generated a net farm loss of $791,578.71. In the same years, plaintiffs reported gains from the sales of yearlings in the amount of $476,243.67, only half of which was taxable income under the treatment afforded long-term capital

gains. See § 1201. Adding the taxable portion of these gains, $238,121.83, to the income plaintiffs received during this period as interest and dividends, $664,439.08, the sum of plaintiffs' ordinary income appears to have been $902,560.91. All but $110,982.20 of this income, however, was offset by plaintiffs' farm losses, which were treated as ordinary deductions. In other words, plaintiffs' investment income and ordinary income from ranching were wholly offset by their farm losses, relieving plaintiffs of any tax liability on those earnings. Plaintiffs' only tax liability, except with respect to their separate business enterprises, was based on the income they derived from selling yearlings, and the tax assessed on that was, at capital gains rates, approximately one-half as much as it would have been on an equivalent amount of ordinary income. It is fair to say, in the broad view at least, that the coincidence of favorable accounting methods for farmers, and favorable tax treatment of capital gains enabled plaintiffs to realize large amounts of income from outside sources, pay no tax on those receipts, reinvest the proceeds in their breeding herd, and pay a tax—and a smaller one at that—only when they later sold some of their cattle. It is clear that this is exactly the situation that Congress viewed as affording an opportunity for abuse, and sought to remedy in § 1251 by restricting the availability of capital gains treatment for the proceeds of livestock sales. Our understanding is confirmed by § 1251 itself, insofar as it excuses from its provisions those farmers who agree to forgo their cash-basis deductions and elect to capitalize the expenses of raising their breeding herds. See § 1251(b)(4).

Congress' cure was to deny capital gains treatment to gains from the sale of certain farm property, most frequently livestock, to the extent that the taxpayer had previously applied current deductions to offset current ordinary income. Such gains are said to be "recaptured" as ordinary income, and not capital gains, in the year the farm property is sold. Section 1251 had a dramatic effect on plaintiffs' tax situation in the very first year of its operation, 1970. That year plaintiffs earned gross farm profits of $28,746.83, but their deductible farm expenses of $232,892.71 left them a net farm loss of $204,145.88.

Plaintiffs also received $95,256.83 from taxable dividends and interest in 1970, which was also wholly offset by their excess deductions. Plaintiffs' other income relevant to this inquiry was $335,503.02 derived from the sales of yearlings, which if treated as capital gains as in prior years would have produced $167,751.51 of taxable income. Of this amount, $108,889.05 could have been offset by the remaining available net farm loss, leaving plaintiffs to pay a tax equivalent to that assessed on only $58,862.46 of ordinary income. It is not difficult to see how Congress could have been offended by such results.

We can hardly doubt, therefore, that Congress aimed § 1251 directly at taxpayers in plaintiffs' situation. Such a missile would not by accident strike its target as accurately as it has in this case. Because plaintiffs had accrued excess farm deductions of $204,145.88, an equivalent amount of their gains from livestock sales cannot qualify for capital gains treatment but must be reported as ordinary income. Added to that sum is one-half of the balance of the sale proceeds, which do qualify for treatment as capital gains. Thus, for purposes of illustration, plaintiffs received $269,824.45 of taxable ordinary income from their ranching business in 1970, rather than the $58,862.42 they reported. The difference between the taxes due on these sums, plus interest, is, in essence, the amount in controversy in this suit. Plaintiffs resist defendant's assessment of this tax deficiency on the ground that § 1251 is unconstitutional.

The statute's complicated mechanism for accomplishing its purpose rests upon the computation of a taxpayer's "excess deductions account," which is generally the excess of the taxpayer's "farm net loss" (which may be used to offset nonfarm income) and his "farm net income." Section 1251(b). The statutory definition of "farm net income" generates no controversy here, but the following definition of "farm net loss" is the target of plaintiffs' constitutional attack:

> (2) FARM NET LOSS.—The term "farm net loss" means the amount by which—

(A) the deductions allowed or allowable by this chapter which are directly connected with the carrying on of the trade or business of farming, exceed

(B) the *gross income* derived from such trade or business.

*Gains and losses on the disposition of * * * [certain farm assets] shall not be taken into account.* [§ 1251(e)(2).] [Emphasis supplied.]

Plaintiffs now contend, as they did before the Commissioner and our Trial Judge, that the sixteenth amendment precludes the statute's attempt to disregard the gains from the disposition of farm property from the special computation of gross income in subsection (B) quoted above, for the purpose of determining the "farm net loss."

In response, defendant offers two theories to support the assessed tax liability. First, defendant denies that any constitutional consideration impedes the operation of § 1251. Then, alternatively, defendant maintains that even if § 1251 were void, plaintiffs would still be unentitled to capital gains treatment under § 1231 because the yearlings plaintiffs sold were property they held primarily for sale to customers in the ordinary course of their trade or business, within the meaning of the exception expressed in § 1231(b)(1)(B).

Our detailed discussion of the circumstances surrounding the enactment of § 1251 will help to show why we find it necessary to address plaintiffs' constitutional contention about § 1251 rather than dispose of the case on § 1231 grounds alone. The Trial Judge pursued the latter route.

The Trial Judge noticed that every year since 1960, at least, plaintiffs had sold about 90 percent of their male yearlings. Among those were some that plaintiffs regarded as suitable for future breeding, but which they did not wish to retain for their own breeding herd. There was evidence that some of these, at least, were put to breeding by their new owners. These facts led the Trial Judge to conclude that plaintiffs had acquired a reputation for raising cattle noted for their outstanding physical characteristics. Plaintiffs' yearlings were sought by ranchers for addition to their own breeding herds. Therefore, the Trial Judge concluded, plaintiffs' selling and, occasionally, trading

yearlings was part of their regular ranching business. Consequently, the Trial Judge regarded the yearlings sold as inventory held by plaintiffs for sale to customers in the ordinary course of their business. As such, the yearlings when sold produced ordinary income for plaintiffs and not capital gains as they would if § 1231 applied. Once plaintiffs were deprived of the application of § 1231, further inquiry into § 1251 was unnecessary. The Trial Judge could dispose of the case in defendant's favor without reaching plaintiffs' constitutional objections. But plaintiffs say the provision respecting livestock in § 1231(b)(3) was expressly written to preclude such a result.

Orthodox doctrine discourages us from addressing a constitutional question that could be avoided, but we find it appropriate to be heterodox here. We have examined the pre-1969 situation in such detail in order to appreciate how Congress obviously perceived a "loophole" in the tax law that permitted certain taxpayers, like plaintiffs, to avoid paying what Congress considered their fair share of taxes, and why Congress prescribed § 1251 as a cure. Congress evidently expects us to follow the route it has charted, and not to persist on the old reef-strewn routes it meant to abandon. A taxpayer should not be allowed to divert us by an insubstantial constitutional contention. It seems that the orthodoxy should not have the same force in such a case as this where the constitutional objection to a statute is rejected as it might where the constitutional contention would otherwise prevail. An additional, practical reason for addressing the constitutional question directly, moreover, is that the IRS relied on § 1251 in assessing the tax deficiency, and plaintiffs asserted in their timely refund claim that the statute was unconstitutional. The alternative contention that plaintiffs' yearlings were inventory, not § 1231 property, was raised for the first time, by defendant, before the Trial Judge. The issue is not without difficulties both factual and legal, and we would have to resolve it without aid from the usual presumption that the Commissioner is correct. If defendant prevails on either ground, plaintiffs have not overpaid their taxes and the petition must be dismissed.

At the heart of plaintiffs' constitutional argument is the sixteenth amendment, which states:

> The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration. [U. S. Constitution, amend. XVI.]

Plaintiffs point out that the Supreme Court has consistently construed the amendment's language to confer upon Congress broad taxing power, broad enough to reach "income from any source whatsoever" if that was Congress' desire. *E.g., Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955) and *United States* v. *Kirby Lumber Co.*, 284 U.S. 1 (1931) (reviewing the constitutionality of § 22(a), the predecessor of current § 61(a)). These cases required the Court to explore the limits of Congressional authority to tax incomes. It is true, of course, that the sixteenth amendment supports a broad construction of the taxing power, whenever Congress chooses to exercise the full measure of its powers. Plaintiffs contend, though, that these decisions establish for the terms "income" as used in the sixteenth amendment, and "gross income" as in § 61(a), a constant, constitutionally mandated meaning from which Congress cannot depart. Plaintiffs would have us conclude that in giving "gross income" a narrower meaning in § 1251(e)(2)(B), quoted above, by excluding certain farm gains, Congress has contravened the sixteenth amendment and acted inconsistently with § 61(a).

We disagree, for it appears that plaintiffs have misapplied the cited precedents, which do not fix a constitutional definition of "income." The sixteenth amendment is an enabling measure, granting Congress certain powers thought to be lacking. But the Constitution nowhere compels Congress to exercise all of its taxing power or none at all. It is common knowledge, to the contrary, that Congress may classify income depending on its source, and exclude from gross income some of the varieties it has identified. *See* Internal Revenue Code of 1954, §§ 101–24. Since the 1930's, we have known that Congress' limited exercise of its taxing authority is not objectionable, *Avery* v. *Commissioner*, 84 F. 2d 905, 907 (2d Cir. 1936), *citing*

Denman v. *Slayton*, 282 U.S. 514 (1931) (approved exclusion from gross income of interest from certain government obligations). We can perceive no objection, therefore, if this is what Congress did here.

Having accepted plaintiffs' premise that Congress has excluded certain types of receipts from income, and refuted their conclusion that such action would have been unconstitutional, we can now indulge ourselves in questioning the premise. We should not allow plaintiffs to persuade us that Congress has, in fact, excluded any income from taxation. It is obvious that Congress' intent was the opposite, to increase plaintiffs' tax burden, not to diminish it, and it chose to do so by taxing more of their income not less. To implement Congress' substantive intent, its draftsmen employed a definition, as legislative draftsmen often do. Plaintiffs' objection is to the mere form of the language Congress used, for they conceded at oral argument that Congress could have accomplished the result without objection if the draftsmen had used different words. There is no confusion over what was the legislative aim, nor any doubt that the purpose was within Congress' constitutional power. That being the case, we recall Holmes' words on the subject:

> * * * [W]hen the legislature clearly indicates that it means to accomplish a certain result within its power to accomplish, it is our business to supply any formula that the *elegantia juris* may seem to require. * * * [*Hoeper* v. *Tax Commission*, 284 U.S. 206, 220 (1931) (dissenting opinion).]

Our business today is to permit the cure Congress prescribed to take effect.

IT IS THEREFORE CONCLUDED AND ORDERED that plaintiffs are not entitled to recover and their petition is dismissed.

Syllabus

551 F. 2d 832

THE CITIZENS NATIONAL BANK OF WACO v. THE UNITED STATES

[No. 390–74. Decided March 23, 1977]

OPINION

Taxes; income tax; exclusions from gross income; interest on tax-exempt municipal bonds; sale v. loan.—This case is before the court on a stipulation of facts. In 1968 American Amicable Life Ins. Co. (Amicable) transferred to plaintiff certain municipal bonds issued by municipalities and school districts of Texas with a total par value of $2,227,000 plus a tax-exempt accrued interest yield. Plaintiff furnished Amicable cash equal to the total par amount plus accrued interest. Plaintiff insisted that Amicable be committed to reacquire the bonds at the same par amount plus accrued interest upon demand because of plaintiff's concern with its liquidity. The bonds were not acquired by plaintiff without assurance that plaintiff could sell or dispose of them without loss and without delay. In 1969 Amicable reacquired the bonds from plaintiff. During 1968 and 1969 plaintiff collected interest on the bonds, and on its respective Federal income tax returns plaintiff treated such interest as tax-exempt income, excluding it from its gross income under Sec. 103(a)(1) of the Code. The Internal Revenue Service, on audit, included in plaintiff's 1968–69 gross income said interest income. Plaintiff paid the deficiencies plus assessed interest, filed claims for refund, and upon their disallowance filed the present tax refund suit. Defendant contends, *inter alia*, that the transfer of the bonds was not a sale but a loan made by plaintiff to either purchase or carry the bonds and held to secure the loan, resulting in a double tax exemption prohibited by Sec. 265 of the Code. Plaintiff asserts that the transaction was an outright sale and that there was no agreement or obligation on its part requiring it to resell the bonds to Amicable on demand. On the basis of the facts of this particular case, it is *held* that the transaction was a sale having economic reality and substance. Plaintiff as owner of the bonds was entitled to collect the interest from the issuer and to deduct it from its gross income under Sec. 103(a)(1) as tax-exempt income. Judgment is entered for plaintiff against defendant for recovery of the deficiency and assessed interest, together with statutory interest, the amount of recovery to be determined in further proceedings under Rule 131(c).

Taxes; income tax; gross income, exclusions from; interest on certain government obligations.

[1] For purposes of determining entitlement to income tax exemption of interest on municipal bonds as a consequence of transfer by the owner thereof to a bank, the controlling question is whether the transfer was a sale or a loan, the answer to which depends upon various criteria, no

single criterion being controlling. As in other litigated cases, the question must be decided on the facts of each case.

Internal Revenue ⚖321

Taxes; income tax; gross income, exclusions from; interest on certain government obligations; sale v. loan.

[2] Where, *inter alia*, the bank-transferee (B) was not required to resell the subject tax-exempt municipal bonds to original owner-transferor (A) but could sell them to a third party and retain the profit, there was no mortgage or pledge agreement of the bonds by A to B, there was no provision for default or foreclosure if A did not repurchase the bonds, B did not advance money to A to buy the bonds from the issuer, B did not hold the bonds for the account of A but for its own account as its own property, B collected the interest from the municipalities for its own account and not as agent of A, no agency agreement existed regarding collection of interest, B never accounted to A for interest collected, B never requested A to repurchase the bonds, even though it could have done so, and A did not deduct on its tax return any interest on the bonds, the transaction is considered a sale having economic reality and substance, rather than a loan, entitling B to an exclusion from its gross income of the interest received on the bonds.

Internal Revenue ⚖321

Taxes; presumption and burden of proof; market value.

[3] Where defendant asserts that the sale and resale of the subject tax-exempt municipal bonds were made at par value without regard to their market value, if market value was material to defendant's claim that plaintiff was not entitled to an exclusion from gross income of the interest on the tax-exempt municipal bonds, defendant had the burden of showing such value and its materiality. Absent such showing the court will assume that value was immaterial.

Internal Revenue ⚖2124

Taxes; revenue laws; construction and operation; generally.

[4] Doubt as to interpretation and operation of the tax laws should be resolved in favor of the taxpayer.

Statutes ⚖245

David B. Kultgen, attorney of record for plaintiff. *Beard & Kultgen*, of counsel.

Robert N. Dorosin, with whom was *Acting Assistant Attorney General Myron C. Baum*, for defendant. *Theodore D. Peyser* and *Donald H. Olson*, of counsel.

Before SKELTON, NICHOLS, and BENNETT, *Judges*.

SKELTON, *Judge*, delivered the opinion of the court:

This is a suit by The Citizens National Bank of Waco, a national bank located in Waco, Texas (Bank or Taxpayer), to recover federal income tax deficiencies and interest assessed against it by the Commissioner of Internal Revenue Service for the years 1968 and 1969, in the total sum of $63,863.24, together with interest as provided by law.[1] The case is before us on an agreed stipulation of facts. We have carefully considered the pleadings, the briefs and the oral argument of counsel, along with the stipulation of facts, and have concluded that the law and the facts are with the plaintiff. We hold for the plaintiff.

The stipulation of facts is relatively short and rather than attempt to summarize its contents, we deem it advisable to reproduce it in full, minus exhibits, so that all facts agreed upon may appear in this opinion. The stipulation of facts, which describes the nature of this controversy, is as follows:

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that for the purposes of this case only the following facts shall be taken as true and that such facts, together with the appended exhibits, which are submitted to show the agreed contents of such documents, represent all of the facts necessary for the Court's disposition of this matter. No further proof is to be offered by either party.

1. Plaintiff is a national banking corporation having its only office in Waco, Texas. As a national bank, plaintiff offered a full line of commercial banking services during the years in question, 1968 and 1969. During 1968 and 1969, the approximate loan limit of the plaintiff was $800,000, or 10 percent of its capital and surplus accounts under applicable banking regulations.

2. American Amicable Life Insurance Company (American Amicable) is a life insurance company having its principal office in Waco, Texas. The principal office of American Amicable is located approximately one-half block from the office of the plaintiff in Waco, Texas.

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[1] It has been agreed between the parties that if the plaintiff prevails in this action the amount of its income tax recovery and assessed interest, plus statutory interest will be computed in proceedings under our Rule 131(c).

3. During 1968 and 1969, and for many years prior thereto, American Amicable maintained a checking account with the plaintiff and regarded the plaintiff as its main bank. During 1968 and 1969, the average balance of the checking account of American Amicable with the plaintiff ranged from $100,000 to $300,000, which was a large account for a bank of plaintiff's size. There had long been a close banking relationship between American Amicable and the plaintiff.

4. American Amicable annually published financial statements which were kept on file by the plaintiff at its office. Plaintiff's president during the years in question, Walter G. Lacy, was a stockholder and a former director of American Amicable.

5. During 1968 and for many years prior thereto, American Amicable maintained a substantial investment in municipal bonds issued by various municipalities and school districts of the State of Texas. These Texas municipal bonds were purchased by American Amicable primarily as long-term investments to obtain the benefit of tax-exempt interest from the bonds. American Amicable periodically purchased these bonds at the then current market price through various brokerage firms in Waco, Texas. These brokerage firms presented to the officers of American Amicable comprehensive background information on the bonds including the credit standing of the issuing municipality, the coupon or stated interest, the current yield, the yield to maturity, the net yield, the par amount of the bonds, and the then present market price of the bonds. American Amicable also occasionally sold the Texas municipal bonds at the then current market price through brokerage firms in Waco, Texas.

6. Plaintiff, acting through its president, Walter G. Lacy, similarly at various times purchased municipal bonds issued by various municipalities and school districts of the State of Texas in prior years and during 1968. These Texas municipal bonds were purchased at the then present market price by the plaintiff primarily for short-term investment from various brokerage firms in Texas. Plaintiff confined its acquisition of Texas municipal bonds to maturity periods of less than 10 years, and it generally

planned to hold such bonds until their maturity. In determining whether the plaintiff should purchase particular Texas municipal bonds with short-term maturities of less than 10 years, Mr. Lacy examined the credit worthiness of the issuing political subdivision, the current market price for the bond, the par amount stated on the bond, the current yield, the yield to maturity, the net yield, and the coupon or stated interest on the bond.

7. At all relevant times, American Amicable was a subsidiary company of the parent holding corporation, Great American Corporation. E. Grant Fitts, the chief executive officer of Great American Corporation, exercised effective control over the management of American Amicable. Shortly before May 22, 1968, Mr. Fitts made a commitment on behalf of American Amicable to purchase $5,000,000 in notes issued by the LTV Corporation. This commitment was made by Mr. Fitts without prior consultation with Franklin Smith, the then president of American Amicable. After making the commitment, Mr. Fitts informed Mr. Smith that it had been made. Mr. Smith notified Mr. Fitts that American Amicable did not have sufficient cash to meet the commitment deadline. As the superior of Mr. Smith, Mr. Fitts insisted that American Amicable obtain the money to honor its commitment. Mr. Fitts told Mr. Smith to obtain the cash for American Amicable by selling its stocks or bonds.

8. Because of the close banking relationship between American Amicable and the plaintiff, Mr. Smith met with Mr. Lacy, president of the plaintiff, and informed him that American Amicable needed cash to fulfill its commitment to purchase notes or debt obligations of the LTV Corporation. As president of American Amicable, it had been Mr. Smith's policy not to borrow money on behalf of American Amicable. Mr. Smith stated to Mr. Lacy that he did not want a loan; he wanted to sell a block of municipal bonds held by American Amicable to the plaintiff for cash. Mr. Smith and Mr. Lacy agreed that American Amicable would transfer to the plaintiff various municipal bonds issued by political subdivisions of the State of Texas with a total par value in the amount of $2,227,000 plus accrued interest, and that plaintiff would furnish American Amicable with

cash equal to the above total par amount of these Texas municipal bonds plus accrued interest. Mr. Lacy agreed to allow American Amicable to select the Texas municipal bonds from its portfolio, provided that American Amicable chose municipal bonds with larger par amounts rather than many different bond issues of smaller par amounts, and with an overall average coupon or stated interest rate of approximately 4.75 percent. At the insistence of Mr. Lacy, Mr. Smith agreed that American Amicable would be obligated to reacquire these Texas municipal bonds at the same par value amount plus accrued interest upon the demand of the plaintiff. Mr. Smith further agreed to Mr. Lacy's request to set forth the agreement between American Amicable and the plaintiff in writing, including, specifically, the above reacquisition commitment.

9. In a letter of May 22, 1968, from Mr. Smith, president of American Amicable, to Mr. Lacy, president of the plaintiff, Mr. Smith stated as follows:

> In accordance with our conversation and agreement, this Company is currently *selling* to your bank a group of Texas Municipal Bonds at par value plus accrued interest. These bonds have an average coupon rate of 4.74 per attached list.
>
> In connection with this sale and additional sales, this Company guarantees to *repurchase* these Bonds on the same basis upon demand from your bank.

In tabular form, Mr. Smith listed on the attachment to his letter the Texas municipal bonds with their par value, coupon or stated interest rate, annual interest, year or years of maturity, and the months in which the bond interest would be paid.

10. According to Mr. Lacy, he insisted that American Amicable be committed to reacquire these Texas municipal bonds at the same par amount plus accrued interest upon demand of the plaintiff because of the plaintiff's concern with liquidity. Since many of the deposits with commercial banks can generally be withdrawn upon demand by their depositors, commercial banks must constantly be aware of their obligations to pay cash upon the request of the depositors. Commercial banks, therefore, are required to maintain a substantial portion of their assets in cash or in

relatively short-term instruments which can be readily converted to cash. Mr. Lacy believed that the plaintiff subsequently might need substantial cash to meet the withdrawal demands of its depositors and would be compelled to dispose of these municipal bonds containing long-term maturities for a substantial loss if the market were depressed at the time when the bank needed to sell the bonds. For this reason, Mr. Lacy was not willing to allow the plaintiff to acquire the municipal bonds in question, almost all of which contained long-term maturities exceeding 10 years, without assurance that the plaintiff could sell or dispose of them without loss and without delay.

11. Under its commitment to reacquire the Texas municipal bonds at the same par value amount upon demand of the plaintiff, American Amicable incurred the risk of loss if the market price of the municipal bonds was less than the total par amount of the bonds. While there was no discussion or agreement among the parties as to the remedy of the plaintiff in the event of a highly improbable default by American Amicable under its bond reacquisition commitment, the plaintiff was fully aware that it had an enforceable obligation against American Amicable.

12. Plaintiff entered into this transaction with American Amicable because of the attractive average overall coupon interest rate of 4.74 percent on the Texas municipal bonds. In 1968, plaintiff was in the 52-percent corporate income tax bracket, and its average annual interest rate charged on commercial loans at that time was 8 percent. Assuming that the coupon interest on the Texas municipal bonds would be tax-exempt income for the plaintiff, the net yield to the plaintiff after income taxes would be approximately 9-½ percent, or a much more favorable return than its taxable 8-percent interest return on loans to corporate borrowers.

13. On or about May 22, 1968, American Amicable actually transferred to the plaintiff municipal bonds issued by various Texas municipalities and school districts with a total par amount of $2,227,000, plus accrued interest, and plaintiff transferred cash in the amount of $2,227,000, plus accrued interest, to the account of American Amicable.

14. Prior to its acquisition of the Texas municipal bonds in question, plaintiff made no effort to determine the actual market price of any of these bonds. The plaintiff also knew that the price at which these bonds were selling in the market varied from par in almost all cases. While it held possession of these municipal bonds, plaintiff never undertook to ascertain the actual market price of any of these bonds, except when it made an annual determination of market value of all bonds held by it.

15. As of May 22, 1968, American Amicable was highly solvent, and there was no reasonable probability that it would be unable to fulfill its commitment to reacquire the Texas municipal bonds at the same par amount upon demand by the plaintiff. Both the plaintiff and American Amicable anticipated when the plaintiff acquired the municipal bonds that American Amicable would rapidly reacquire these bonds as permitted by its cash flow. At the aforementioned meeting between Mr. Smith and Mr. Lacy, Mr. Smith notified Mr. Lacy that American Amicable would reacquire these Texas municipal bonds as fast as it could justify, depending upon its normal cash flow. American Amicable wanted to reacquire these municipal bonds because they represented a good, safe investment with a tax-exempt interest yield. In reply, Mr. Lacy explained to Mr. Smith that the plaintiff was entering into the transaction based upon the overall average coupon interest rate of 4.74 percent on the bonds. Consequently, he expected American Amicable to keep this overall average coupon interest rate intact as it reacquired the bonds. Plaintiff would have strongly objected if American Amicable had proceeded to initially reacquire the higher coupon interest bonds and thereafter reacquire the smaller coupon interest bonds. American Amicable reacquired the municipal bonds in an equitable manner with respect to the maintenance of the average overall coupon interest rate.

16. Plaintiff never made a demand upon American Amicable to reacquire the Texas municipal bonds in question. As permitted by its cash flow, American Amicable throughout 1969 regularly reacquired these municipal bonds by making requests for reacquisition of such bonds to the plaintiff by telephone or in person. Although there was

no agreement that the plaintiff was required to allow American Amicable to reacquire such bonds upon its demand or request, plaintiff always honored these requests of American Amicable.

17. The last two municipal bonds held by the plaintiff were reacquired by American Amicable on December 11, 1969. As American Amicable reacquired these municipal bonds, the only necessary computation for the parties was the calculation of accrued interest because the par value of the bonds was the same.

18. The transaction in question between the plaintiff and American Amicable furnished financial assistance to American Amicable by making available cash needed to purchase the notes of the LTV Corporation.

19. Although Mr. Smith and Mr. Lacy believed that the plaintiff was free to sell or otherwise dispose of these bonds to parties other than American Amicable, the plaintiff made no effort to dispose of these bonds. The plaintiff merely held these bonds until reacquired by American Amicable and collected the interest income from the bonds.

20. During 1968, the plaintiff collected interest on the Texas municipal bonds in the amount of $40,287.25. During 1969, the plaintiff collected interest from the Texas municipal bonds in the amount of $64,250.48.

21. On its federal income tax returns for the years 1968 and 1969, the plaintiff treated such interest as tax-exempt income which it excluded from its gross income under Section 103(a)(1) of the Internal Revenue Code of 1954. On audit, the Commissioner of Internal Revenue, among other adjustments, included in plaintiff's gross income for the years 1968 and 1969 the interest income collected by the plaintiff from the municipal bonds in question.

22. The Commissioner determined income tax deficiencies against the plaintiff for the years 1968 and 1969.

23. Plaintiff paid an income tax deficiency of $30,292.75, plus assessed interest in the amount of $5,577.18, for a total of $35,869.93 on May 16, 1972, with respect to its calendar year 1968, and plaintiff paid an income tax deficiency of $61,586.40, plus assessed interest in the amount of $7,623.21, for a total of $69,209.61 on May 16, 1972, with respect to its calendar year 1969.

24. On November 28, 1973, plaintiff filed a claim for refund for the year 1968 in the amount of $21,271.80 plus interest in the amount of $3,915.80. Also, on November 28, 1973, plaintiff filed a claim for refund in the amount of $33,924.25 plus interest in the amount of $4,751.39. The Internal Revenue Service denied these claims for refund on June 14, 1974, and the plaintiff timely filed a petition in this Court on November 8, 1974.

25. If the plaintiff should prevail in its contention that its transaction of May 22, 1968, with American Amicable constituted a bona fide sale rather than a secured loan for tax purposes, the amounts of income tax and deficiency interest to be refunded to the plaintiff, which are attributable to inclusion in its gross income of the interest income from the municipal bonds, will be computed in proceedings under Rule 131(c).

The defendant contends that the transfer of the bonds by American Amicable (Amicable) to the Bank was not a sale but was a loan made by the Bank to Amicable to either purchase or carry the bonds, which were held as collateral by the Bank to secure the loan, all of which resulted in a double tax exemption prohibited by Section 265 of the Internal Revenue Code of 1954, which provides as follows:

> § 265. Expenses and interest relating to tax-exempt income.
>
> No deduction shall be allowed for—
>
> * * * * *
>
> (2) Interest.
>
> Interest on indebtedness incurred or continued to purchase or carry obligations * * * the interest on which is wholly exempt from the taxes imposed by this subtitle. [26 U.S.C. § 265 (1970)]

Defendant contends further that in collecting the interest from the issuing municipalities, the Bank was acting as the agent of Amicable.

The defendant also argues that there was an agreement between the parties (by implication) that the Bank was required to resell the bonds to Amicable at any time that Amicable requested it.

The plaintiff Bank, on the other hand, says that the transaction was an outright sale of the bonds to it by Amicable and that there was no agreement or obligation whatever on the part of the Bank requiring it to resell the bonds to Amicable on demand. The Bank points out that it did not advance any money to Amicable to be used by Amicable to purchase the bonds nor to carry the bonds, and that the Bank did not itself buy the bonds from the issuing authorities, but did collect the interest as owner for its own account from the municipalities. The Bank denies that there was a double tax exemption in this case and says that the only tax exemption that occurred was the deduction it made on its income tax which it says it was entitled to under Section 103(a)(1) of the Code which provides as follows:

> § 103. Interest on certain governmental obligations. (a) General rule.
>
> Gross income does not include interest on—
>
> (1) the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia;
>
> * * * * *

[26 U.S.C. § 103(a)(1) (1970)]

The main issue to be decided is whether the transaction was a sale or a loan. We have concluded that it was a sale. Counsel for the government has made an ingenious argument that it was a loan, however, the facts do not support his loan theory, but point the other way. It occurs to us that defendant's loan theory is just a "theory" that is based largely on speculation, surmise, inference and what might have been the situation, assuming certain vital facts existed. There were too many material facts, some present and some lacking that show the transaction was not a loan. Many of them, some of which overlap, may be listed as follows:

1. There was no debt, existing or created, due by Amicable to the Bank.
2. No note or written evidence of debt existed.

3. There was no evidence Amicable ever promised to pay the Bank anything.
4. No date for the payment of money or repurchase of the bonds existed.
5. There was no mortgage or pledge agreement of the bonds by Amicable to the Bank.
6. No evidence existed that Amicable pledged the bonds as collateral for any kind of loan.
7. There was no provision for default or foreclosure if Amicable did not repurchase the bonds.
8. The president of Amicable stated in the beginning he did not want a loan, but wanted to sell the bonds to the Bank.
9. The transaction was in the form of an outright sale.
10. Amicable was the owner of the bonds when the transaction occurred.
11. The Bank did not advance money to Amicable to buy the bonds from the issuer.
12. The Bank did not buy the bonds from the issuing authority for the account of Amicable.
13. The Bank did not hold the bonds for the account of Amicable, but for its own account as its own property.
14. The Bank did not advance money to Amicable to carry the bonds, as the Bank was not required to resell the bonds to Amicable on demand or otherwise.
15. The Bank collected the interest from the municipalities for its own account and not as agent of Amicable.
16. In collecting the interest on the bonds, there is no evidence whatever that the Bank acted as agent of Amicable. No agency agreement existed.
17. The Bank never accounted to Amicable for interest it collected from the municipalities, nor was it required to do so.
18. Amicable never paid the Bank any interest whatever, except accrued interest on the bonds at the time of repurchase, which is customary in financial circles when bonds are purchased.
19. The Bank never requested Amicable to repurchase the bonds, even though it could have done so.
20. The Bank had the right to sell the bonds to third parties and retain any profit made on such sale as its own property.
21. There is no evidence that Amicable made any entry on its books that it owned the bonds or that it owed the Bank anything on the bonds after they were transferred to the Bank. If its books and records were not correct in this regard, it would no doubt have been in violation of the insurance laws of Texas.

22. There is no evidence that the Bank was guilty of making false entries on its books in violation of national banking laws in connection with the transaction.
23. Amicable did not deduct any interest on the tax-exempt bonds from its income tax during the time they were owned by the Bank.

Defendant relies on the decisions in *American National Bank of Austin* v. *United States*, 421 F.2d 442 (5th Cir. 1970), *cert. denied*, 400 U.S. 819; *First American National Bank of Nashville* v. *United States*, 467 F.2d 1098 (6th Cir. 1972); *Union Planters National Bank of Memphis* v. *United States*, 426 F.2d 115 (6th Cir. 1970), *cert. denied*, 400 U.S. 827, to support its position. These cases involve different facts, are distinguishable from the instant case, and do not control our decision, as will be shown below. The cases called to our attention that have been decided in this area of the law are the following: *American National Bank of Austin, supra; First American National Bank of Nashville, supra; Union Planters National Bank of Memphis, supra; Third National Bank in Nashville*, 71–1 USTC 9248 (1971); *First National Bank in Wichita* v. *Commissioner*, 57 F.2d 7 (10th Cir. 1932), *cert. denied*, 287 U.S. 636; *Brown-Crummer Co.*, 19 B.T.A. 750 (1930), petition dismissed on motion of the Commissioner, 63 F.2d 996 (1933); *Commissioner* v. *Bank of California Nat. Ass'n.*, 80 F.2d 389 (9th Cir. 1935), *aff'g*, 30 B.T.A. 556; and *Commissioner* v. *Wells Fargo Bank & Union Trust Co.*, 80 F.2d 390 (9th Cir. 1935), *aff'g*, B.T.A., Memo Docket Nos. 49880, 63038.

The Fifth Circuit Court of Appeals pointed out in *American National Bank of Austin, supra*, at 445, that the decided cases on sale-repurchase agreements of municipal bonds announce various criteria for determining where ownership of bonds reside in these situations, and while they are helpful, no single criterion is controlling. We agree that this question must be decided on the facts in each case and that is the procedure we follow in the instant case. The court in the above case decided against the bank and held that the transactions were loans and not sales. However, the facts in that case were vastly different to those in the instant case. There, various bond dealers bid on municipal bonds and in many cases sold the bonds to

individual customers before they were issued. The bank had nothing to do with fixing the bid price nor with the bidding or purchase of the bonds. It merely paid for the bonds to the issuing authorities. When the bonds were issued, they were sent to the bank on instructions of the dealers and the bank held them as collateral for the account of the dealers who had "complete dominion over the bonds after they came into the bank's possession." The dealer "sold them at his pleasure, at prices he determined, and without reference to the bank, except that the proceeds were collected from the customer by the bank and applied to the dealer's account. Obviously the inventory of bonds was being held by the bank for the dealers and subject to their disposition. To us the bank was simply a lender of its funds to the dealers. For this service it was paid interest by the borrowing dealers." (*Id.* at 452.) The facts in that case show further that when the dealer had sold the bonds and the bank had collected the money from the customer for the account of the dealer, the dealer reimbursed the bank for the bid price it had advanced, adjusted for interest, and also paid the bank *a handling charge and incidental expenses.* During the time the bank held the bonds for the dealers, it collected interest from the issuing authorities and excluded it from its income tax as tax exempt interest paid to it (as owner of the bonds) under Section 103(a)(1) of the Code. The court held that the bank's alleged ownership of the bonds had no economic substance and that it was not entitled to treat the interest as tax exempt income. We agree that the decision of the court in that case was correct, but point out that the case is clearly distinguishable from our case.

The *Union Planters National Bank of Memphis, supra,* is also distinguishable from the case before us. That case, like the *American National Bank of Austin, supra,* involved transactions between the bank and bond dealers. In fact, the court stated that many dozens of transactions were involved (*see* 426 F.2d 115, n. 3 at 117). The facts in that case show that the bank would purchase bonds from dealers under agreements that the bank could require the dealers to repurchase the bonds at any time without loss to the bank. The district judge also found that the dealers

could force the bank to resell the bonds at any time on demand of the dealers.[2] The dealers exercised control over the bonds while they were in possession of the bank by advertising them for sale in trade magazines in complete disregard of the fact they had been transferred to the bank. When the dealers found a purchaser for the bonds, they would obtain the bonds from the bank by paying the bank the amount it had advanced, with adjusted interest. In the meantime, if the market value of the bonds went down, the bank required the dealers to pay sufficient money to protect it from the declining market. The court compared this to the posting of additional margin by a borrower in a falling market situation. The court said in this regard:

> * * * It is clearly more consistent with the characterization of these transactions as loans than as sales [426 F.2d at 117.]

During the times the bank held the bonds, it collected the interest due thereon from the issuing authorities and excluded it as tax-exempt interest in its income tax. The court held this to be improper, as the transactions had no economic substance as sales, but were in fact loans. It should be pointed out that this practice continued over a period of several years and involved many dozens of transactions, with the obvious result that the bank was advancing money to the dealers to finance their purchases and sales of bonds to the general public and that the bank held the bonds for the account of the dealers and subject to their order and that the money advanced by the bank was in fact loans to the dealers to carry on their bond business. No such facts exist in the case at bar.

Bond dealers were also involved in *First American National Bank of Nashville, supra.* We think that case is also distinguishable from the case before us. There the transactions that were involved, other than certain transfers to trust accounts not material here, were of two categories as follows: "(1) Instead of purchasing municipal bonds for which they had successfully bid, certain bond dealers orally agreed with appellant that the bank would buy the bonds from the issuers and later sell them to the

[2] This circumstance is not present in the instant case.

dealers at the price the bank had paid. Until these latter sales occurred, the bank in each case accrued the interest on the bonds at the coupon rate and credited this interest to an exempt-interest account. In no case did a successful bidder fail to buy the bonds from the bank at the bid price. (2) Instead of consummating purchase agreements they had made with bond dealers, certain customers of appellant orally agreed with the bank that it would acquire the bonds from the dealers and later sell them to the customers at the prices it had paid, with adjustments for accrued interest. Here, too, the bank reported the accrued interest as tax-exempt income." (467 F.2d at 1100)

The court, relying on the *American National Bank of Austin* case and the *Union Planters National Bank of Memphis* case, discussed above, held that the transfers to the bank were not sales, that the bank advanced and loaned money to purchase the bonds and held the bonds until redeemed in connection with loans instead of sales. It appears from these facts that as to the first category the bank furnished money to *purchase* the bonds from the issuer which runs afoul of Section 265(2) of the Code so as to deny tax-exemption to the bank as to interest on the bonds. It is not clear whether the bank furnished money to purchase the bonds from the issuer in the second category, but in any event, the bank furnished money to the bank's customers to *carry* the bonds, which prevents the interest from being tax-exempt under Section 265(2) of the Code. None of these facts exist in the instant case.

Other cases cited by defendant are *Third National Bank in Nashville* v. *United States*, 27 Am. Fed. Tax R.2d 71–818 (M.D. Tenn. 1971), and *First National Bank in Wichita* v. *Commissioner*, 57 F.2d 7 (10th Cir. 1932), both of which also involve the financing by banks of bond dealers in the sale of bonds and are distinguishable from the instant case in much the same way the preceding cases have been distinguished. It is significant that the cases relied on by defendant all involve the financing of bond dealers by banks in connection with the sale of tax-exempt bonds to the general public. This contrasts with the instant case where we have a single isolated transaction where no one is involved except Amicable and the Bank. The deal

between them appears to have been a straightforward aboveboard arm's-length sale and resale between two reputable business institutions, with no thought or purpose of tax evasion. The defendant has never claimed that the transaction was a sham nor a scheme that was carried out for the purpose of tax evasion. It is likely that had Amicable not repurchased the bonds from the Bank, no tax deficiency would have ever been assessed against the Bank. Nevertheless, the Bank finds itself caught in the backwash of the bond dealer decisions, which the government apparently seeks to extend to the instant case. We think the cases are entirely different, and if there is any similarity, it is very remote and speculative.

The Bank cites *Commissioner* v. *Bank of California*, 80 F.2d 389 (9th Cir. 1935), *aff'g*, 30 B.T.A. 556, and *Commissioner* v. *Wells Fargo Bank & Union Trust Co.*, 80 F.2d 390 (9th Cir. 1935), *aff'g*, B.T.A., Memo Docket Nos. 49880, 63038 in support of its position. In the *Bank of California* case, the bank bought certain tax-exempt bonds by bills of sale, absolute on their face, purporting to transfer and assign the bonds to the bank at the prices specified therein. The bank collected the interest on the bonds and deducted it from its income tax as exempt income. The Commissioner of Internal Revenue contended that although, in form, the transactions were purchases and sales of bonds, they were intended to be, and were in fact, loans of money by the bank to the seller, secured by a pledge of the bonds and that the bonds never were, in fact, the property of the bank, and that the bank was not entitled to deduct the interest from its gross income. The bank contended that it purchased the bonds and became the owner thereof and, consequently was entitled to treat the interest on the bonds as tax-exempt income. The Board of Tax Appeals upheld the bank (30 B.T.A. 556) and the Commissioner appealed. On appeal, the Ninth Circuit Court of Appeals affirmed the Tax Court, saying:

> * * * The Board found that the transactions referred to were actual purchases, not loans of money secured by pledge, and that the bonds belonged to and were the property of respondent. [The bank.] This finding is

supported by substantial evidence and is, therefore, conclusive. [Cases cited.] [80 F.2d at 390.]

In the *Wells Fargo* case, the Ninth Circuit Court stated:

> The question presented in this case is identical with that presented in Commissioner v. Bank of California (C.C.A.) 80 F. (2d) 389, decided this day. What we said in that case is applicable here. [80 F.2d at 390.]

The defendant attacks these cases as being old and out of date and not in step with more modern decisions of the Supreme Court that hold that economic substance of a transaction controls instead of the form of the transaction. This argument is unpersuasive in the instant case, because we hold that the sale of the bonds to the Bank had economic reality and substance.

The Bank points to Rev. Rul. 74–27, 1974–1 C.B. 24 as supporting its position. That ruling, says the Bank, lists conjunctively the factors that must be present in a sale-repurchase agreement in order for the transaction to be a loan instead of a sale, as follows: The seller could require the bank to resell; the bank could require the seller to repurchase; a definite remedy was provided in the event of default of either party; the seller agreed to pay interest at a stipulated rate on the funds advanced by the bank; and the value of the securities sold did not necessarily equal the amount advanced by the bank. The Bank contends that *all* of these features must be present in the agreement in order for the transaction to be a loan, and says that only two were present, namely (1) agreement of the seller to repurchase, and (2) want of equality of purchase price and market value of the bonds. Three of the listed features are not present says the plaintiff, which are: (1) agreement of the bank to resell, (2) payment by the seller of specified interest on the amount paid, and (3) agreed remedies in case of default. The plaintiff argues that since all of the listed features are not present, the ruling supports the Bank's contention that the transaction was a sale and not a loan.

Defendant counters with the argument that the ruling was grounded upon the economic realities of the underlying transaction and that the policy of the Internal Revenue

Service is shown in the ruling to be that substance rather than form governs in situations of this kind. It admits that some of the features of the transaction favor the Bank, but contends that the "indicia of a secured loan clearly predominate over those suggesting a sale." Defense counsel was fair enough to say in his brief:

> * * * As frequently happens, however, where federal tax issues turn on the essential nature of a particular transaction, this case involves some indicia pointing each way. * * * [*Id.* at 18.]

At the same time, plaintiff's counsel was frank enough to say in his brief:

> * * * While the repurchase agreement in the present case contains some of the listed features [in the Ruling], it lacks others. [*Id.* at 14.]

The court commends counsel for both parties for their candor and forthrightness to the court and to each other in conceding that there are certain facts in the case before us that are favorable to each of the parties. It is now our duty to sift the facts and decide which predominate and control.

The Bank places great emphasis on the fact that it was not required to resell the bonds to Amicable, but could sell them to a third party and keep the profit, if any, due to market value if it desired to do so. The defendant says there was an "implied" agreement that the Bank could be required to resell the bonds to Amicable. This argument is unpersuasive because there is no evidence to support it. We conclude that the Bank was not required to resell the bonds to Amicable. This is a very important fact in this case. It tends to prove and indicates that the Bank was the owner of the bonds and could keep them to maturity or sell them to Amicable or anyone else. Also, this circumstance shows that the Bank did not advance money to Amicable to carry the bonds.

Defendant says that the Bank insulated itself from loss by providing that Amicable would repurchase the bonds at par value on demand. While this arrangement did insulate the Bank from loss, there is no evidence that this was the reason for this provision. Rather, the stipulation of facts (paragraph 10) shows that the Bank wanted to keep itself

in a liquid position so that if required it could pay its depositors in cash on demand. This appears to have been a prudent and wise decision on the part of the Bank and one that accords with sound banking practices. The stipulation of facts does not show that any thought was given by the Bank to protect itself from any loss. These facts satisfactorily explain why the Bank required Amicable to repurchase the bonds on demand.

The defendant makes a point that the sale and resale of the bonds were made at par value without regard to their market value. However, there was no proof of the market value of the bonds at any time. If market value was material to defendant's claim, it had the burden of showing such value and its materiality. Having failed to discharge this burden, we must assume that such value was not material to any issue in this case.

While we have no doubt as to the meaning of the provisions of the Code involved here as applied to the facts of this case, should there be any doubt it must be resolved in favor of the taxpayer. *See Porter* v. *Commissioner*, 288 U.S. 436, 442 (1933); *United States* v. *Merriam*, 263 U.S. 179, 188 (1923); and *Luzier's, Inc.* v. *Nee*, 24 F.Supp. 608, 610 (W.D. Mo. 1938).

We hold that the transaction involved in this case was a sale, with economic substance, of the bonds by Amicable to the Bank and not a loan made by the Bank to Amicable to purchase the bonds from the issuer or to carry the bonds, and that there was no double tax exemption in the case. We hold further that the Bank as owner of the bonds was entitled to collect the interest from the issuer and deduct it from its gross income under Section 103(a)(1) as tax-exempt income.

Conclusion

Judgment is entered for the plaintiff against the defendant for the recovery of the deficiency assessment and interest thereon in connection with the bonds in question, together with statutory interest until paid. The case is remanded to the trial judge for a determination of the amount of income tax and deficiency interest to be

refunded to the plaintiff which are attributable to inclusion in its gross income of the interest income from the municipal bonds, plus statutory interest, under Rule 131(c) of this court.

NICHOLS, *Judge*, concurring:

I concur with Judge Skelton's opinion and with the judgment of the court. I would like to add the following comment:

Defendant on oral argument asserted, or admitted, as one prefers, that its position was that the ostensible transactions described in the stipulation were mere shams to cover up what was in reality a loan secured by collateral. There is not much in the stipulation to support this, and what there is appears almost wholly a matter of negative inference, as *e.g.*, the apparent indifference of the parties to the market value of the bonds. Pars. 14 and 17 of the stip. Such a document is a wholly inadequate basis for an argument of the kind defendant makes. In *Kramer* v. *United States*, 186 Ct. Cl. 684, 692, 406 F. 2d 1363, 1367 (1969), the court said:

> * * * Here, defendant wants us to infer from the stipulated family relationship that the agreement really imports something different from what it says. It invokes the presumption in favor of the Commissioner's decision and reminds us that the burden of proof is on plaintiff. However, the submission via stipulation, of a contract, without more, satisfies the burden of establishing that the parties agreed to what the contract says. One who intends to argue that there were side agreements, oral, implied, or merely understood, should not stipulate a basic contract alone. * * *

In accordance with the opinion of the court, a memorandum report of the trial judge and a stipulation of the parties, it was ordered on July 1, 1977 that judgment for plaintiff be entered for $63,311.41, plus statutory interest.

Syllabus

552 F.2d 343

TEKTRONIX, INC. v. THE UNITED STATES AND THE HICKOK ELECTRICAL INSTRUMENT COMPANY, JETRONIC INDUSTRIES, INC., AND LAVOIE LABORATORIES, INC., THIRD-PARTY DEFENDANTS

[No. 79–61. Decided March 23, 1977]*

ON THE PROOFS

Patents; accounting; compensation; reasonable rate; delay compensation.—In *Tektronix, Inc.* v. *United States*, 195 Ct. Cl. 53, 445 F. 2d 323 (1971), the court held that claims of eight patents relating to oscilloscopes and their electronic circuitry are valid and infringed, and that plaintiff is entitled to recover reasonable and entire compensation. In the present phase of the case, it is *held* that the proper royalty rate is 10% as representing what reasonable parties might well have agreed upon, and, applying that rate, plaintiff is entitled to recover $2,129,808 as the principal sum of its compensation under 28 U.S.C. § 1498, plus delay compensation. It is also *held*, as to delay compensation, that the series of interest rates established in *Pitcairn* v. *United States*, 212 Ct. Cl. 168, 547 F. 2d 1106 (1976), are appropriate, applied each year at simple interest to the sums then owing plaintiff. The amount of delay compensation will be determined under Rule 131(c).

Patents; infringement; compensation; generally.

[1] Recovery of reasonable compensation under 28 U.S.C. § 1498 is premised on a theory of an eminent domain taking under the Fifth Amendment, just compensation for an eminent domain taking being governed by basic equitable principles of fairness.

United States ⚖97

Patents; infringement; compensation; reasonable or established royalty rate.

[2] Where an established royalty rate for patented inventions is shown to exist, that rate will usually be adopted as the best measure of reasonable and entire compensation for patent infringement by the United States; but even an established royalty may be modified upward or downward depending on circumstances of the case. Where no established royalty exists, one may be selected on the basis of royalty rates for related patents; a settlement rate may be considered or other contracts between the parties may be used as a guide; savings realized by the United States as a result of the infringement are sometimes used as a measure of compensation; and lost profits have been awarded.

Patents ⚖319(1)

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* See Order entered June 24, 1977, *post* at 307, on defendant's and plaintiff's motions for rehearing.

Syllabus

Patents; infringement; compensation; reasonable or established royalty rate.

[3] A royalty rate based on licensing programs of giant corporations is not an appropriate basis for determining compensation for infringement by the United States of a patent owned by a company not comparable in size, nor possessed of either a comparable patent portfolio or a comparable product line, nor under the spur of antitrust decrees.

United States ⚖97

Patents; infringement; compensation, measure of.

[4] Where the patentee has no established royalty rate and where the court, for purposes of determining an appropriate basis for compensation for patent infringement, has rejected the licensing program of giant corporations, and where the evidence shows that during the period of infringement by the United States plaintiff realized on its commercial sales an average profit of 23.7% and 27.7% on its two types of device (after consideration of direct and indirect costs), a declining royalty starting at 1½% is unsatisfactory as just compensation for the Government's use of the patents in suit.

Patents ⚖319(1)

Patents; infringement; compensation, measure of; lost profits.

[5] Although plaintiff was ready, willing and able to supply the Government's needs for the subject commercial devices, and assuming that lost profit is still a viable measure of recovery under 28 U.S.C. § 1498, that standard cannot be adopted here absent clear and convincing evidence that plaintiff would actually have supplied all the "commercial" devices the Government purchased elsewhere, or that if plaintiff had been the source of those devices it would have kept the profits sought here. If lost profits are ever to be awarded under Sec. 1498, it should be only after the strictest proof that the patentee would actually have earned and retained those sums in its sales to the Government.

United States ⚖97

Patents; infringement; compensation; reasonable or established royalty rate.

[6] The best method of computing compensation for unauthorized use of the patented invention at issue in this case is by adopting a reasonable royalty based on a willing-buyer/willing-seller concept as exemplified in *Georgia-Pacific Corp.* v. *U.S. Plywood-Champion Papers, Inc.*, 446 F. 2d 295 (2d Cir.), *cert. denied*, 404 U.S. 870 (1971), in which the court reasoned that had the infringer taken a license rather than infringe, the infringer would have been willing to pay as a royalty the sale price of the patented article as sold by the infringer, minus the cost of manufacture of the article and minus the infringer's usual profit. The willing-buyer/willing-seller concept is a device in aid of justice, and the validity of the concept as a means of arriving at reasonable compensation does not depend on the actual willingness of the parties to engage in such negotiations.

Patents ⚖319(1)

Syllabus

Patents; infringement; compensation; reasonable or established royalty rate.

[7] In computing compensation under the willing-buyer/willing-seller concept of *Georgia-Pacific Corp.*, while plaintiff realized a profit, which encompassed gain on the whole device, in excess of 25% on its non-Government sales of the infringed device, and is entitled to substantial compensation for the risks and expenses it bore and for its creative ingenuity, since a reasonable potential licensee would likely not be willing to pay royalty of 25%, the material before the court, and absent hard proof warranting use of more precise standards, a proper royalty rate is 10% but no higher, representing what reasonable parties might well have agreed upon if both were reasonably trying to reach an agreement.

United States ⚖97

Patents; infringement; compensation; reasonable or established royalty rate.

[8] The reasonable and entire compensation standard of 28 U.S.C. § 1498 was designed to accomplish complete justice as between the patent owner and the United States under the just compensation clause of the Fifth Amendment; the goal of complete justice implies that only a reasonable, not an excessive, royalty should be allowed where the United States is the user–although the patentee, as a monopolist, might be able to exact excessive gains from private users. It is equally a fundamental element of fairness to avoid excessive compensation to the condemnee as it is to be sure not to undercompensate.

United States ⚖97

Patents; infringement; compensation; reasonable or established royalty rate.

[9] Where an unpatented component is financially dependent on the market created by the patented device which requires the component before the device has utility, it is proper to include the component in the base on which royalties are calculated even though the component is physically separate.

Patents ⚖319(1)

Patents; infringement; compensation; delay compensation.

[10] Delay compensation is a component of the "reasonable and entire compensation" standard of 28 U.S.C. § 1498, and should in this case be applied at the yearly rates, at simple interest, established in *Pitcairn* v. *United States*, 212 Ct. Cl. 168, 547 F. 2d 1106 (1976). The old 4% rate is abandoned as hopelessly antiquated. It will further the goal of equal justice, reduce costs and complexity of litigation, and facilitate decision, to accept and establish the *Pitcairn* rates and method for all pending and future just compensation cases, except where the parties stipulate otherwise or in other special cases, such as where Congress has established a different rate.

United States ⚖97

Robert C. Miller, attorney of record, for plaintiff; *Norman Eric Jorgensen,* of counsel.

Thomas J. Scott, Jr., with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Richard J. Egan, attorney of record, and *Baldwin, Egan, Walling & Fetzer,* of counsel, for Third Party Defendant The Hickok Electrical Instrument Company.

Boris Haskell, attorney of record, for Third Party Defendant Jetronic Industries, Inc.

Robert E. Burns, attorney of record, for Third Party Defendant Lavoie Laboratories, Inc.

Before COWEN, *Senior Judge,* DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG and BENNETT, *Judges, en banc.*

DAVIS, *Judge,* delivered the opinion of the court:

In *Tektronix, Inc. v. United States,* 195 Ct. Cl. 53, 445 F.2d 323, 170 U.S.P.Q. 100 (1971), claims in eight patents owned by plaintiff were held to be valid and infringed. The present task is to fix the reasonable compensation to which plaintiff is entitled under 28 U.S.C. § 1498, including a sum for the delay in payment. Former Trial Judge Cooper concluded that Tektronix should recover the basic amount of $4,831,773, plus compensation for delay computed at simple interest (varying from 4.60% in 1960 to 6.59% in 1969) on the amounts allocable to the individual years in which infringement occurred, such interest to be paid until the principal sum is satisfied. Both sides have sought review, both as to the principal amount and as to delay compensation. Though we agree with, and borrow from, much of the trial judge's reasoning, we come to different results on both the basic compensation and the delay payments.

I.

The patents in suit relate to oscilloscopes and their electronic circuitry. Since defendant now concedes that all of the oscilloscopes here accused are covered by one or more claims of one or more of the patents, it is unnecessary

to discuss in detail either the patents or the accused devices. However, it is pertinent to note the importance of the patents in suit and the impact they have had on the industry.

Plaintiff was organized in 1946, specifically to manufacture oscilloscopes designed by its then-president Howard Vollum. Research and development, funded by plaintiff, ultimately led to the model 516, 535, 535A, 545, and 545A oscilloscopes, all of which embody the patents in suit.[1] These oscilloscopes (or scopes) met with resounding success upon entering competition with those manufactured by nationally known competitors. They were deemed at the time to be superior in engineering and performance to all other scopes in their class and defendant purchased them in substantial numbers.

In 1958, apparently desirous of having alternative sources of supply and not wishing to pay plaintiff's price,[2] defendant issued an invitation for bids, inviting manufacturers to submit bids on an oscilloscope which was to consist of "one each oscilloscope subassembly MX-2330( )/G; Tektronix, Inc. Model 535," and "one each preamplifier AN-1839( )/USM; Tektronix, Inc. type 53/54C." The Hickok Electrical Instrument Company responded to the invitation and agreed to furnish a "Tektronix, Inc. Model 535 as manufactured by Hickok."

To fulfill this contract, Hickok purchased a 535 oscilloscope from Tektronix and began to manufacture copies. Subsequently, two other companies, Jetronic Industries and Lavoie Laboratories, Inc.,[3] were awarded contracts to manufacture competing copies of the Tektronix scopes. It is clear from the evidence that defendant, unable to obtain comparable, noninfringing scopes from alternative sources, tailored its procurement specifications in such a way as to make infringement of plaintiff's patents a virtual prerequi-

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[1] Patent No. 2,883,619 is concerned with electrical probes used with these scopes. The evidence is insufficient to make any determinations regarding reasonable compensation for use of that particular patent.

[2] Plaintiff's catalog prices remained constant at $1,400 for the model 535 and $1,550 for the model 545 scopes, respectively, from 1959 to 1968. Throughout this period, plaintiff maintained a volume discount policy on its sales.

[3] Lavoie is now bankrupt and has not participated in these accounting proceedings.

site for obtaining the Government contracts. By essentially copying plaintiff's instruments, and without incurring the costs of engineering and developing the instruments, the third-party defendants (Hickok, Jetronic, Lavoie) were able to underbid plaintiff on contracts for the procurement of these scopes. This, of course, resulted in substantial savings to defendant, both on the purchase of the scopes and on the purchase of the related, but unpatented, plug-ins used with the scopes. Defendant realized these savings while at the same time taking advantage of plaintiff's extensive service and field organization to help with the training of its employees in the use and servicing of the infringing scopes.

The period of infringement extended from 1959 to 1969 and involved the procurement by defendant of 17,542 scopes at a net cost (for scopes only) of approximately $16,944,840. The infringing scopes bear the model designations 1805, 1805A, USM/81, LA261, LA265, LA265A, LA545, AN/USM–105, AN/USM–140, and AN/USM–141.

With the exception of the last three models, each of those scopes was supplied to the Government in direct competition with plaintiff's commercial scopes. The remaining three scopes, comprising 8,437 of the total, although embodying the circuits of the patents in suit, were militarized or more rugged versions developed by the Hewlett-Packard Company which had attempted to design around plaintiff's patents but, finding it could not, had requested and was granted a cross-license arrangement with plaintiff. Plaintiff did not market, and did not seek to bid on, scopes of this type, choosing to restrict its efforts to the commercial scopes. Hickok and Lavoie did, however, bid on and receive contracts for supplying these militarized scopes and, in so doing, extended their infringing activities.

II.

The parties[4] are in agreement that plaintiff has no established licensing program or royalty applicable to the patents in this accounting. Beyond that, however, they have urged wholly divergent theories of recovery in the

[4] The third parties have, for all practical purposes, embraced the position of defendant, so it is unnecessary to discuss their individual views.

Trial Division and before the court on review. The polar nature of their respective views is revealed by a comparison of the end result each party arrives at as to what constitutes reasonable and entire compensation. Not including delay damages, defendant's sum is on the order of $185,445, while plaintiff's sum is set at $12,094,638. The disparity in their positions also extends to the issue of delay damages where plaintiff contends for damages up to $25,005,090, while defendant proposes a much more modest $91,590.

Defendant's basic theory, premised on *Badowski* v. *United States*, 150 Ct. Cl. 482, 278 F. 2d 934, 137 U.S.P.Q. 656 (1960), and *Saulnier* v. *United States*, 161 Ct. Cl. 223, 314 F. 2d 950, 137 U.S.P.Q. 222 (1963), lumps all the infringing devices into one category and leads to a reasonable and entire compensation equivalent to a nominal sliding-scale royalty based on the selling price of the oscilloscope only, without regard to any unpatented ancillary equipment sold with the scope. As a guide for selecting a suitable royalty rate, defendant relies on the licensing practices of RCA and Western Electric, both of which granted licences in the commercial electronics field at rates ranging from 2% down to 1%, the latter rate being applicable to sales to the Department of Defense. Defendant suggests that a sliding scale of 1.5% on the first $2 million, 1.2% on the next $3 million, and 1% on the remainder, would be appropriate here.

Plaintiff, on the other hand, divides the contracts for the procurement of infringing scopes into two categories, the first being those contracts that, in its view, would have been awarded to plaintiff "but for" the infringement, while the second consists of those contracts for the rugged or militarized scopes on which plaintiff did not bid and which it could not have supplied. With respect to the first category, plaintiff asks for an amount that would place it in as good a pecuniary position as it would have been had it received the infringing procurement. In short, plaintiff seeks lost profits, its authority consisting principally of two cases: *Imperial Machine & Foundry Corp.* v. *United States*, 69 Ct. Cl. 667, 5 U.S.P.Q. 332 (1930), and *Waite* v. *United States*, 69 Ct. Cl. 153, 4 U.S.P.Q. 387 (1930), *rev'd on other*

grounds, 282 U.S. 508 (1931). As to the second category, plaintiff concedes a lost-profit theory is inapplicable and contends that compensation must be determined by adopting a reasonable royalty based on a willing-buyer/willing-seller concept as enunciated in *Georgia-Pacific Corp.* v. *U.S. Plywood-Champion Papers, Inc.*, 446 F. 2d 295 (2d Cir. 1971), 170 U.S.P.Q. 369, *cert. denied*, 404 U.S. 870 (1971).

III.

It is settled that recovery of reasonable compensation under § 1498 is premised on a theory of an eminent domain taking under the Fifth Amendment. *Calhoun* v. *United States*, 197 Ct. Cl. 41, 51, 453 F. 2d 1385, 1391, 172 U.S.P.Q. 438 (1972); *Pitcairn v. United States*, 212 Ct. Cl. 168, 547 F. 2d 1106 (1976). The Supreme Court has in many cases emphasized that basic equitable principles of fairness are the governing consideration in determining just compensation for an eminent domain taking. In *Almota Farmers Elevator & Warehouse Co.* v. *United States*, 409 U.S. 470 (1973), it was stated, at 473–74:

> The Fifth Amendment provides that private property shall not be taken for public use without "just compensation." "And just compensation means the full monetary equivalent of the property taken. The owner is to be put in the same position monetarily as he would have occupied if his property had not been taken." *United States* v. *Reynolds*, 397 U.S. 14, 16 (footnotes omitted). See also *United States* v. *Miller*, 317 U.S. 369, 373. To determine such monetary equivalence, the Court early established the concept of "market value": the owner is entitled to the fair market value of his property at the time of the taking. *New York* v. *Sage*, 239 U.S. 57, 61. See also *United States* v. *Reynolds*, *supra*, at 16; *United States* v. *Miller*, *supra*, at 374. And this value is normally to be ascertained from "what a willing buyer would pay in cash to a willing seller." *Ibid.* See *United States* v. *Virginia Electric & Power Co.*, 365 U.S. 624, 633.
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> * * * * *

And, at 478:

> "The constitutional requirement of just compensation derives as much content from the basic equitable principles of fairness, *United States* v. *Commodities*

Trading Corp., 339 U.S. 121, 124 (1950), as it does from technical concepts of property law." *United States* v. *Fuller*, *post*, at 490. It is, of course, true that Almota should be in no better position than if it had sold its leasehold to a private buyer. But its position should surely be no worse.

Those same principles have long guided this court in its assessment of reasonable compensation. For example, in *Olsson* v. *United States*, 87 Ct. Cl. 642, 659–60, 25 F. Supp. 495, 499 (1938), 37 U.S.P.Q. 767, 770, *cert. denied*, 307 U.S. 621 (1939), it was said:

> * * * The rule to be applied in measuring the compensation depends upon the facts and circumstances of each case, but the end to be obtained in every case is always the same, namely, the determination and allowance of just compensation to the patentee for the value to him of the right or license to use appropriated by the Government. *Richmond Screw Anchor Company* v. *United States*, 275 U.S. 331; * * * *The Berdan Fire-Arms Manufacturing Company* v. *United States*, 26 C. Cls. 48, 82. * * *

Where an established royalty rate for the patented inventions is shown to exist, that rate will usually be adopted as the best measure of reasonable and entire compensation. *See, e.g., Carley Life Float Co.* v. *United States*, 74 Ct. Cl. 682 (1932). But where no such royalty is shown, alternative methods must be employed.[5]

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[5] Even an established royalty may be modified upward, *Meurer Steel Barrel Co.* v. *United States*, 85 Ct. Cl. 554, 34 U.S.P.Q. 123, *cert. denied*, 302 U.S. 754 (1937), or downward, *Fauber* v. *United States*, 112 Ct. Cl. 302, 81 F. Supp. 218, 79 U.S.P.Q. 410 (1948), *cert. denied*, 337 U.S. 906 (1949), depending on the circumstances of the case. Where no established royalty is found, one may be selected on the basis of royalty rates for related patents, *Breese Burners, Inc.* v. *United States*, 140 Ct. Cl. 9, 115 U.S.P.Q. 179 (1957). A settlement rate may be considered, *Saulnier* v. *United States*, 161 Ct. Cl. 223, 314 F. 2d 950, 137 U.S.P.Q. 222 (1963), or other contracts between the parties may be used as a guide, *Barlow* v. *United States*, 87 Ct. Cl. 287, 34 U.S.P.Q. 127 (1937). Savings realized by the defendant as a result of the infringement are sometimes used as a measure of compensation, *Shearer* v. *United States*, 101 Ct. Cl. 196, 60 U.S.P.Q. 414, *cert. denied*, 323 U.S. 676 (1944); *Olsson* v. *United States*, 87 Ct. Cl. 642, 25 F. Supp. 495, 37 U.S.P.Q. 767 (1938), *cert. denied*, 307 U.S. 621 (1939), and lost profits have been awarded. *Imperial Machine & Foundry Corp.* v. *United States*, 69 Ct. Cl. 667, 5 U.S.P.Q. 332 (1930); *Waite* v. *United States*, 69 Ct. Cl. 153, 4 U.S.P.Q. 387 (1930), *rev'd on other grounds*, 282 U.S. 508 (1931).

IV

In this case, it is necessary to adopt a method other than reliance on an established royalty for ascertaining what would be reasonable. However, neither defendant's nominal sliding-scale royalty nor plaintiff's lost-profit theory provides a satisfactory basis on which to base a decision in this case.

A.

The Government's proposal is rejected because the evidence on which it is premised is not at all analogous to the facts here. Defendant relies on the licensing programs of RCA and Western Electric but it seems clear that plaintiff—which was not a company comparable in size to those corporate giants, nor possessed of either a comparable patent portfolio or a comparable product line, nor under the spur of an anti-trust decree—should not be governed by the same considerations. Items such as transistors, tubes, and similar electronic components are comparatively simple in structure, have a relatively low per-unit cost, and are sold and used in very large quantities. Plaintiff's oscilloscopes, on the other hand, are much more complex, have a much higher per-unit cost, and the quantities sold are much lower.[6] Moreover, the evidence is that during the 1960's, plaintiff was realizing on its commercial sales an average profit of 23.7% on the 535 scope and 27.7% on the 545 scope, those figures reflecting plaintiff's margin on these products after both direct and indirect costs had been considered. In view of those figures, defendant's suggestion that plaintiff should be forced to accept a declining royalty starting at 1½% for its inventions could not, without the greatest difficulty, be accepted as just compensation for use of the patents.

B.

With respect to plaintiff's lost-profit contention, there is no doubt that plaintiff was ready, willing, and able to

[6] Defendant also puts forward the Raytheon licensing program, but Raytheon's subminiaturized tubes are very different from oscilloscopes and hardly comparable.

supply defendant's needs for commercial scopes. But even if we assume that lost profit is still a viable measure of recovery under 28 U.S.C. § 1498, we cannot adopt that standard in this case because it has not been sufficiently shown by clear and convincing evidence that plaintiff would actually have supplied all the "commercial" scopes the Government bought from the third-party respondents, or that if plaintiff had been the source of those items it would have made and kept the profits it now demands. For one thing, Tektronix had granted a paid-up cross-license under the patents in suit to Hewlett-Packard which was legally competent to bid against plaintiff for the sale of "commercial" scopes to the Government. Hewlett-Packard did not in fact bid against the third-party defendants with their low prices, but it is too much of a leap to assume that it would not have competed with plaintiff if the latter had alone been bidding, at its much higher prices, for the Government business. As evidenced by the scale of plaintiff's earnings on its non-Government sales, the profits to be made by an authorized seller, at the high prices legally available to it, may very well have lured Hewlett-Packard to enter the field. There is, in short, inadequate proof that, if the Government business had had to be confined to authorized sellers, plaintiff rather than Hewlett-Packard would have gotten it. By the same token there is no adequate proof that any share taken by plaintiff would have been at the level of prices or profit to which plaintiff was accustomed. The potential competition of Hewlett-Packard may have forced or induced Tektronix to cut its profits on Government sales—or the impact of the Renegotiation Act may have reduced the profits it now says it would have made. If lost profits are ever to be awarded under § 1498, it should be only after the strictest proof that the patentee would actually have earned and retained those sums in its sales to the Government. That kind of demonstration does not exist in this case.

We are constrained to point out, in addition, that in any event plaintiff's "lost profits" (assuming that they were absolutely certain) would be so high as to amount to excessive compensation, rather than the just compensation payable under the Fifth Amendment. *See* Part V, *infra*.

V.

Like the trial judge we conclude that the best method of computing compensation in this case is to adopt the approach of establishing a reasonable royalty for both the commercial and the militarized scopes. That method, exemplified by the *Georgia-Pacific* case, *supra*, involves a willing-buyer/willing-seller concept, in which a supposititious meeting between the patent owner and the prospective manufacturer of the infringing item is held to negotiate a license agreement.[7] In *Georgia-Pacific*, the court reasoned that had the infringer taken a license rather than infringe, the infringer would have been willing to pay as a royalty the sale price of the patented article as sold by the infringer, minus the cost of manufacture of the article and minus the infringer's usual profit. In that case, the infringer's usual profit was 9% so that 9% of the selling price was deducted from the profit pool generated by the sale of the patented article and awarded to the infringer, while the remainder of the profit constituted the royalty to be remitted to the patentee. On the facts in that case, the royalty, expressed as a percentage, was 22.36% of the infringer's sale price.

Defendants object to employing a willing-buyer/willing-seller approach, asserting that plaintiff has never been willing to grant any of the defendants a license under these patents. Of course, whether this is the fact or whether, as plaintiff contends, defendants were never willing to pay a reasonable royalty, is irrelevant. The willing-buyer-/willing-seller concept is, as Judge Learned Hand termed it, "a device in aid of justice," *Cincinnati Car Co.* v. *New York Rapid Transit Corp.*, 66 F. 2d 592, 595, 19 U.S.P.Q. 40 (2d Cir. 1933). As such it is employed by the court as a means of arriving at reasonable compensation and its

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[7] This willing-buyer/willing-seller technique in determining a reasonable royalty has not been a stranger to the Court of Claims. *Olsson v. United States*, *supra*; *Badowski v. United States*, 150 Ct. Cl. 482, 485, 278 F.2d 934 (1960); *Ushakoff v. United States*, 179 Ct. Cl. 780, 785–86, 375 F.2d 822, 825, 153 U.S.P.Q. 410 (1967); *Amerace Esna Corp. v. United States*, 199 Ct. Cl. 175, 462 F.2d 1377, 174 U.S.P.Q. 517 (1972). For cases from other courts, see, *e.g.*, *Jenn-Air Corp. v. Penn Ventilator Co.*, 394 F.Supp. 665, 185 U.S.P.Q. 410 (E.D. Pa. 1975).

validity does not depend on the actual willingness of the parties to the lawsuit to engage in such negotiations.

Although we accept the trial judge's general approach, we depart from his application of the willing buyer/willing seller criterion. We reconstruct, as he did, a hypothetical negotiation in 1959 between Hickok, the first prospective infringer, and plaintiff; the subject of the negotiation would be the patent rights to the oscilloscope Hickok intended to supply to defendant. The negotiation formula which the trial judge borrowed from *Georgia-Pacific* is, as already mentioned, to start with the infringer's selling price, deduct its costs in order to find its gross profit, then allocate to the infringer its normal profit, and end up with the residual share of the gross profit which can be assigned to the patentee as its royalty. We utilize the same formula as the beginning of our supposititious negotiation, and likewise start with Hickok's proposed selling price—but thereafter our calculation differs from the trial judge's:

Hickok's proposed selling price	$1,137
Costs:	
Direct or variable manufacturing	486[8]
Fixed burden, marketing, administration, etc.	533[9]
Costs subtotal	1,019
Gross profit	118
Hickok Profit	31[10]
Residual Share (7.65% of unit price)	87

The trial judge's computation (using the above format but different figures, as explained in notes 8–10) resulted in a residual share of 27.5% of the unit price, all of which he

[8] This figure is the same as the trial judge's and is based on *plaintiff's* 1959 direct cost, Hickok's cost not being available.

[9] The trial judge based his figure ($256) on an *estimate* of *plaintiff's* indirect costs for 1959 (plaintiff's actual indirect costs for 1959 are not available) but did not include the amounts paid to employees under the profit-sharing program. Our figure of $533 includes the profit-sharing expenses (treated as wages) and is based on extrapolation backward from plaintiff's 1961 actual cost. In the absence of acceptable cost data from Hickok, we use (as did the trial judge) plaintiff's more accurate cost data for 1959 and 1961, but unlike the trial judge we assume that the 1961 indirect costs increased over 1959 in the same proportion as did the direct costs.

[10] Based on Hickok's average profit from 1960 to 1968 of 2.7%. The trial judge's number of $82 was based on the profit rate of 7.23%, taken from Hickok's figures for the particular contract which was the basis of the calculation and adjusted for profit-sharing. The defendant would use $65, Hickok's actual profit under the particular contract used as the initial basis of the calculation.

allocated to plaintiff as its reasonable royalty. We disagree with that result (as indicated in the above notes) principally because it understates the indirect costs of manufacture and thus inflates the residual share.

The defendant's recomputation leads to a residual share of 4.6% of unit price which it is willing to give to plaintiff (if defendant's primary contention based on the Western Electric-RCA-Raytheon licenses is rejected, as we have in Part IV, B, *supra*). That conclusion we also reject because, in our view, it assigns a larger profit to the potential infringer (Hickok) than the latter actually experienced over the infringement period and would be willing (in our view) to anticipate; defendant's computation therefore leaves too small a residual share for plaintiff. Hickok would be satisfied, we think, with a relatively low profit because the product to be made by it under plaintiff's patents would not involve any unusual risks or require large-scale investments in marketing, advertising, or tooling.

We do not, however, stop with the 7.65% of unit price which our own calculation produces for plaintiff's residual share. We think that a reasonable patentee in the position of plaintiff, which was realizing a profit in excess of 25% on its own non-Government sales of oscilloscopes, would have insisted on a somewhat higher royalty than 7.65%, and that a reasonable potential licensee would have agreed, in order to be able to sell the item without legal question—even if at a somewhat higher price than if no royalty were to be paid. Such a potential licensee, if reasonable, would recognize that plaintiff, which took the risks and bore the expense of developing the scopes and creating a market for them, was entitled to substantial compensation for those efforts and for its ingenuity in creating this important and effective instrument. But we do not believe that such a reasonable potential licensee would be willing, or could be expected to be willing, to pay as a royalty the 25% or so plaintiff was making in profit on its own non-Government sales of scopes.[11] A portion of that 25% profit represented

[11] In the trial judge's opinion plaintiff's profits could go as high as 60% but plaintiff insists that, if its overhead were properly distributed over all sales, profits would be in the range of 25–27%.

compensation, not for the patented idea itself, but for the efficiencies and risks of manufacture as well as the investment of other capital. Certainly that portion of plaintiff's profit is separate and apart from any compensation due it for use of its patents. In any event, a royalty of 25% is very high and unlikely to be paid by a willing licensee which is content to make a very low profit for itself.

We select 10% as the proper royalty rate. This represents our best judgment, on the material we have before us, of what reasonable "parties might well have agreed upon" (*Saulnier* v. *United States, supra,* 161 Ct. Cl. at 227, 314 F.2d at 952, 137 U.S.P.Q. at 224), "what the parties would have agreed upon, if both were reasonably trying to reach an agreement" (*Amerace Esna Corp. v. United States, supra,* 199 Ct. Cl. at 182, 462 F.2d at 1380, 174 U.S.P.Q. 517). One may label this as akin to a "jury verdict" but, in the absence of hard proof warranting the use of more precise standards, the "whole notion of a reasonable royalty is a device in aid of justice, by which that which is really incalculable shall be approximated. * * * It is no more impossible to estimate than the damages in many other torts * * *." *Cincinnati Car Co.* v. *New York Rapid Transit Corp., supra,* 66 F.2d at 595, 19 U.S.P.Q. at 43.

In our view no rate higher than 10% is called for. As already indicated, plaintiff's profit in excess of 25% on its non-Government sales[12] does not mean that the royalty for the patents alone should equal or approach that figure which encompasses the gain on the whole item. Tektronix did not manufacture or sell the scopes here involved and is not entitled to a profit on their fabrication and vending.[13] For a comparable reason, it is not conclusive that non-

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[12] As we have pointed out (*see* note 11), the trial judge thought Tektronix' profits could even rise to the 60% level if the volume was high enough, though plaintiff disputes that figure.

[13] Plaintiff would undoubtedly have insisted on, and would have made, an acceptable profit if there had been no patents or if the patents had expired. We have already held, *supra,* that plaintiff has failed to prove that it would necessarily have supplied the scopes if the defendant had limited its procurement to authorized manufacturers, or that it would have made the "lost profits" it now claims.

Government purchasers paid plaintiff prices which enabled it to make such profits on manufacture and sale of the scopes. In addition, royalty rates higher than 10%, though not unknown, seem to be relatively unusual, particularly in the electronics field.

Nor should it be forgotten, when plaintiff's high profits are brought forward for comparison, that the standard of 28 U.S.C. § 1498—"reasonable and entire compensation"—was designed "to accomplish complete justice as between the plaintiff and the United States" under the just compensation clause of the Fifth Amendment. *Waite v. United States,* 282 U.S. 508, 509 (1931). That goal of "complete justice" implies that only a reasonable, not an excessive, royalty should be allowed where the United States is the user—even though the patentee, as a monopolist, might be able to exact excessive gains from private users. Much of the content of the constitutional requirement of just compensation derives from the basic equitable principles of fairness as between the Government and its citizens. *See Almota Farmers Elevator & Warehouse Co. v. United States,* 409 U.S. 470, 478 (1973); *United States v. Fuller,* 409 U.S. 488, 490 (1973); *United States v. Commodities Trading Corp.,* 339 U.S. 121, 124 (1950). It is equally a fundamental component of fairness to avoid excessive compensation to the condemnee as it is to be sure not to pay him too little.

VI

With respect to the base to which the royalty is to be applied, it appears that the plug-ins are useless without the scopes and that the scopes require a plug-in before they have any utility. It also appears that the plug-ins are financially dependent on the market created by the patented scopes. Normally the patentee (or its licensee) can anticipate sale of such unpatented components as well as of the patented scopes. On these facts, there is sound authority for including the plug-ins in the base on which the royalties are calculated, even though the plug-ins are physically separate. *See e.g., American Safety Table Co. v. Schreiber,* 415 F.2d 373 (2d Cir. 1969), 163 U.S.P.Q. 129,

cert. denied, 396 U.S. 1038 (1970); *Shearer v. United States*, 101 Ct. Cl. 196, 218, *cert. denied*, 323 U.S. 676 (1944). Plaintiff's patents were of such paramount importance that they substantially created the value of the plug-ins, and therefore the "entire market value rule" applies. *See Marconi Wireless Telegraph Co. v. United States*, 99 Ct. Cl. 1, 46–49, 53 U.S.P.Q. 246, 249–50 (1942), *modified on other grounds*, 320 U.S. 1 (1943).

The trial judge recognized this principle but ruled that the plug-ins should be included only in the base for the "commercial" scopes, not the "militarized" ones.[14] We see no valid basis for this distinction and cover the plug-ins into the base for both types of oscilloscopes. As did the trial judge, we exclude packaging and other miscellaneous costs which plaintiff sought to include at trial.

VII

Accepting the 10% rate set in Part V, *supra*, and the base-including-plug-ins, as discussed in Part VI, *supra*, we conclude that the royalty base for the "commercial" scopes is $9,740,385, and for "militarized" scopes it is $11,557,695. The total is $21,298,080. Applying the royalty rate of 10% to this base, we reach $2,129,808 as reasonable and entire compensation under 28 U.S.C. § 1498 (to which delay compensation must be added, *see* Part VIII, *infra*).[15]

VIII

As for the delay compensation which is a component of "reasonable and entire compensation" *(Waite v. United States, supra)*, the parties agree that it is appropriately computed at something more than the traditional 4% employed in the past. Both sides have presented evidence to support their varying theories. The trial judge, basing his determination on the yield of Aaa corporate bonds and

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[14] The only grounds he gave for the differentiation were "the royalty rate [which he had set at 27.5%], the magnitude of the procurement involved, and other factors present in this case." The royalty rate we fix (10%) is considerably lower than the trial judge's.

[15] Trial Judge Cooper's figure for reasonable and entire compensation (aside from delay compensation) was $4,831,773.

actual Treasury securities, concluded that a separate rate should be set for each of the infringement years (1960–1969).[16] This rate was to be applied (at simple interest) to the royalties accruing in that year (at the beginning of the next year) and thereafter held constant to the date of payment.

Very recently in *Pitcairn v. United States*, 212 Ct. Cl. 168, 547 F. 2d 1106 (1976), Part V of that opinion, we adopted a series of interest rates in a comparable patent suit under 28 U.S.C. § 1498, the rates to be applied each year, at simple interest, to the sums then owing to the plaintiff.[17] We hold that these rates should be applied (from now on) to just compensation cases, without need of proof in the individual instance, unless and until it is affirmatively demonstrated that under the theory of the *Pitcairn* opinion the rate for years after 1975 should differ from the 7½% rate set for 1971–1975. The old 4% rate[18] is now hopelessly antiquated and it is too burdensome to require parties to make specific proof in every case as to the appropriate interest rate. Until just the other day, the then current rate was mechanically used, without any evidence or proof that it was proper in the particular case. We follow the same course. It will further the goal of equal justice, reduce the costs and complexity of litigation, and facilitate decision (as well as settlement) to accept and establish the

[16] The trial judge recommended the following rates:

Year	Percentage
1960	4.60
1961	4.37
1962	4.45
1963	4.21
1964	4.37
1965	4.70
1966	4.74
1967	5.70
1968	6.20
1969	6.59

[17] The rates established in *Pitcairn* were:

1947–1955	4%
1956–1960	4–½%
1961–1965	4–¾%
1966–1970	6–½%
1971–1975	7–½%

[18] Beginning in 1944 the rate of 4% was automatically used until somewhat over a year ago.

Pitcairn rates and method, for the years through 1975, for all pending just compensation cases and those to be brought in the future.[19] Accordingly, in the present case we substitute the *Pitcairn* rates and method for the formula adopted by the trial judge.

Our conclusion is that plaintiff is entitled to recover $2,129,808 as the principal sum of its compensation under 28 U.S.C. § 1498, plus delay compensation. The amount of delay compensation will be determined (under Part VIII of this opinion) by the Trial Division under Rule 131(c).

BENNETT, *Judge*, concurring:

I join in the court's opinion but think it appropriate to add a few comments on the issue of delay compensation. The court today establishes for all future cases rates of simple interest for given periods to be awarded for delay in receipt of payment for property taken by the Government, as part of the just compensation mandated by the fifth amendment. *Seaboard Air Line Ry.* v. *United States*, 261 U.S. 299 (1923); *King* v. *United States*, 205 Ct. Cl. 512, 504 F. 2d 1138 (1974). In dissent Judge Skelton takes the court to task on its power to fix a rate of interest for delay compensation in cases not presently before it. Pointing to such enactments as the so-called Declaration of Taking Act, 40 U.S.C. § 258a (1970), Judge Skelton concludes that "[t]hese statutes demonstrate that if a fixed inflexible rate of interest is to be established in condemnation cases, it must be done by Congress and cannot be done by this court by way of judicial legislation." The dissent errs, I think, by failing to take into account the history of delay compensation law.

Though Congress has from time to time established by statute the rate of interest for delayed compensation in certain situations and geographic areas, the norm is for the court to be without explicit statutory guidance in setting the interest rate. Early decisions of the Supreme Court in *United States* v. *North American Transp. & Trading Co.*,

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[19] Except where the parties stipulate otherwise or in other special cases, which we do not now pass upon, such as where Congress has established a different rate.

253 U.S. 330 (1920), and *Seaboard Air Line Ry.* v. *United States, supra,* denied the availability of relief in the Court of Claims in inverse condemnation situations on a theory other than implied contract, thus ruling out the payment of delay compensation under the fifth amendment obtainable in district court eminent domain actions. By the late 1920's, however, this court was allowing interest in its judgments, as additional sums to compensate for delay in receipt of payment, in cases where the Government had expressly and clearly exercised its condemnation power. *Vandiver* v. *United States,* 67 Ct. Cl. 125 (1929) (taking of part of Aberdeen Proving Grounds); *Schroth* v. *United States,* 65 Ct. Cl. 49 (1928), 67 Ct. Cl. 382 (1929). In 1938, in a patent case referred by Congress, *Barlow* v. *United States,* the court observed, 87 Ct. Cl. 281, 286, that it was "unaware of any established precedent which fixes the rate of interest to be allowed in eminent domain cases as a part of just compensation," citing *Shoshone Indians* v. *United States,* 85 Ct. Cl. 331 (1937), *aff'd,* 304 U.S. 111 (1938). The court had stated in the latter case that the rate of interest allowed as part of just compensation is to be derived from the economic circumstances of the times intervening the taking and payment dates, as they affect the party whose property is taken:

> The field for investment by an Indian tribe was and is limited in the absence of an agreement to a deposit of the amount due the Indians in the Treasury of the United States and the payment thereon by the government of interest at the rate of 5 percent. The field for investment by citizens [sic] of funds received for property taken, and paid contemporaneously with the taking, is unlimited, and he is in a position and capable of taking full advantage of the local rate of interest. If, therefore, his money is not paid at the time of the taking, but later, the courts add to the value of his property at the time of taking an additional amount measured by interest, usually at 6 percent per annum, and, in some cases, a higher rate which he probably would have earned with his capital to the date of payment. * * *. [85 Ct. Cl. at 380.]

By 1946 it was clear that recovery on an inverse condemnation action brought in the Court of Claims could be founded on the fifth amendment, *United States* v.

Causby, 328 U.S. 256, permitting the allowance of interest as part of the judgment for just compensation. *Fonalledas* v. *United States*, 123 Ct. Cl. 483, 107 F. Supp. 1019 (1952). Also in 1946, in an eminent domain case founded on a statute, this court repeated the *Barlow* observation that "there is no statute or rule fixing any particular rate [of delay compensation interest] to be allowed," confirmed that since the determination of fifth amendment compensation is exclusively a judicial function "it is for the Court to fix upon the rate it will allow," and noted that the allowance of a "uniform rate does in fact avoid discrimination among litigants," a discrimination that presumably would be present if the interest rate allowed depended upon the state of proof or the legal rate in the plaintiff's locality. *Arkansas Valley Ry.* v. *United States*, 107 Ct. Cl. 240, 259, 68 F. Supp. 727, 730 (1946), *cert. denied*, 330 U.S. 811 (1947). Thereafter, in a case citing *Arkansas Valley Ry.*, the court rejected proposed variations in the rate of just compensation interest used in a large number of previous taking cases, noting the lack of a controlling statute or rule but asserting the prudence of uniformity. *Carlstrom* v. *United States*, 147 Ct. Cl. 297, 306, 177 F. Supp. 245, 250 (1959). Later opinions adhered to these thoughts. *Confederated Salish & Kootenai Tribes* v. *United States*, 193 Ct. Cl. 801, 825–26, 437 F. 2d 458, 472 (1971); *Drakes Bay Land Co.* v. *United States*, 198 Ct. Cl. 506, 520–21, 459 F. 2d 504, 511–12 (1972).

Not until *King* v. *United States*, *supra*, did the court approve a variance from the then standard 4-percent rate. The difference in *King* was that the parties stipulated to the use of interest rates more nearly akin to long-term Government bond interest rates paid during the period of delay in compensation. In *Pitcairn* v. *United States*, Ct. Cl. No. 50328, 212 Ct. Cl. 168, 547 F. 2d 1106 (1976), investment return rates found as facts by the trial judge were employed to measure the plaintiff's delay compensation due. However, the use of neither the stipulation nor the fact-finding to adjust the interest rate, during a period when the prevailing market rate obviously had jumped to a higher plateau than was true in the preceding several decades since the Great Depression, precluded the court

from "fix[ing] upon the rate it will allow" and keeping this rate "uniform" over a given period of time. *Arkansas Valley Ry.* v. *United States, supra.*

A brief review of selected cases from this court since the demise of the "implied contract" theory of inverse condemnation reveals that the constitutionally appropriate rate of delay compensation interest has been periodically ascertained by the court and then held constant over a span of time. Moreover, this has occurred quite without the direction of the statute that the dissent thinks necessary. For non-Indian claims, which *Shoshone Indians* v. *United States, supra,* sets apart from Indian claims, the court allowed 6 percent from taking dates in 1917 and 1918, respectively, in *Vandiver* v. *United States, supra,* and *Schroth* v. *United States, supra.* A 5-percent rate was allowed in several cases whose taking dates preceded the foregoing, but whose judgments came down substantially after the cases. *Marconi Wireless Tel. Co.* v. *United States,* 99 Ct. Cl. 1 (1942), *rev'd in part on other grounds,* 320 U.S. 1 (1943) (taking dates ranged from 1911 to 1919); *National Elec. Signaling Co.* v. *United States,* 99 Ct. Cl. 621 and 646, 49 F. Supp. 754 and 768 (1943) (two cases—taking dates of 1918 and 1914, respectively). The rate in *Barlow* v. *United States, supra,* the taking in which occurred in 1919, was also fixed at 5 percent. Then, with the advent of the Great Depression, the general market rate diminished somewhat, and so did the delay compensation rate allowed. In *Willow River Power Co.* v. *United States,* 101 Ct. Cl. 222 (1944), *rev'd on other grounds,* 324 U.S. 499 (1945), the rate was set at 4.5 percent from the taking date in 1938 to the date of payment. Thereafter, the 4-percent rate became entrenched in the case law, and came to be applied almost automatically until the *King* decision. *See Atwater* v. *United States,* 106 Ct. Cl. 196 (1946) (taking in 1941); *Schaffer* v. *United States,* 104 Ct. Cl. 229, 60 F. Supp. 760 (1945) (wartime property requisition, 1942); *Arkansas Valley Ry.* v. *United States, supra; Turney* v. *United States,* 126 Ct. Cl. 202, 115 F. Supp. 457 (1953) (taking in 1947); *Miller* v. *United States,* 135 Ct. Cl. 1, 140 F. Supp. 789 (1956) (1948 seizure of airplanes for security reasons); *Carlstrom* v. *United States, supra; A.J. Hodges Indus., Inc.*

v. *United States*, 174 Ct. Cl. 259, 355 F. 2d 592 (1966) (avigation easement, 1958); *Drakes Bay Land Co.* v. *United States, supra*. For Indian taking claims, 5 percent was generally allowed until 1934, when the rate changed to 4 percent. *Shoshone Indians* v. *United States, supra* (5 percent allowed from 1878 to date of payment, judgment in 1937); *Uintah & White River Bands of Ute Indians* v. *United States*, 139 Ct. Cl. 1, 11–12, 152 F. Supp. 953, 958 (1957) (5 percent from 1905 to 1934, 4 percent thereafter); *Confederated Salish & Kootenai Tribes* v. *United States, supra* (5 percent from 1912, 4 percent from 1934).

As I think the foregoing demonstrates, the court's exercise of its power today in fixing past period interest rates for future cases is neither extraordinary, without historical foundation, nor ill advised. The *Arkansas Valley Ry.* rationale of avoiding discrimination among diverse taking claimants is as valid today as it was when first stated. Today's decision will place less of a burden on the litigating parties and the court, by exercise of power well grounded in the court's past, and yet take account of financial market realities too long ignored in the eminent domain, inverse condemnation, and patent decisions of this and other courts. For these reasons, I concur in the court's opinion.

SKELTON, *Judge*, concurring in part and dissenting in part:

I agree with all of the majority opinion in this case except that part of it that deals with delayed compensation. The court adopts the rates of interest awarded in *Pitcairn* v. *United States*, 212 Ct. Cl. 168, 547 F. 2d 1106 (1976), and holds that such rates should be applied from now on, without any proof, in just compensation cases. The effect of this holding will require this court to award seven and one-half percent interest in all condemnation cases during the period 1971 to 1975, and in all pending and future condemnation cases, without any proof of the proper interest rate.

In my opinion, this court is without authority to make any such rule because it amounts to legislation that can only be enacted by Congress.

In the past, Congress has fixed interest rates in condemnation cases. See 16 U.S.C. § 79c(b)(2) (1970) wherein Congress provided for the payment of six percent interest for the taking of any property by the United States in the Redwood National Park of California. Also in the Declaration of Taking Act, 40 U.S.C. § 258a (1970), 46 Stat. 1421, Congress specified that six percent would be paid as a part of just compensation for a taking of land by the United States. These statutes demonstrate that if a fixed inflexible rate of interest is to be established in condemnation cases, it must be done by Congress and cannot be done by this court by way of judicial legislation.

Furthermore, the majority decision in the instant case is in direct conflict with the decision of the Ninth Circuit Court of Appeals in *United States* v. *Blankinship*, 543 F.2d. 1272 (1976), wherein that court held that the proper rate of interest in a condemnation case should be the same as a direct obligation of the United States Treasury having a duration approximating the period during which the deficiency was unpaid (*i.e.*, long term Government obligations).[1] This procedure has not been followed by the majority in the instant case. It is true the trial judge considered the yield of Treasury securities and also the yield of AAA corporate bonds, but it is not shown whether the Treasury securities were of short or long term duration, nor which type of security was relied on by the trial judge. In any event, the majority rejected the interest allowance of the trial judge in its entirety and substituted its own interest rates without any proof to support them.

Also, the trial judge arrived at an interest rate for the year in which each taking occurred and held that it must remain constant until paid. This was correct as a matter of principle, but the majority changed the rate every five or six years. This is contrary to interest payments on long term Government securities where the interest rate remains constant until maturity of the securities. It is

[1] See my dissent in *Pitcairn* v. *United States*, *supra*,.

impossible to change the interest rate on long term Government obligations every few years if the interest rates in the financial world fluctuate up and down.

I would remand this part of the case to the trial judge with instructions to fix the interest rate for the periods in question according to the yield of Government obligations with duration approximating the periods of time from the date of each taking until paid, and that once the interest rate was determined for each taking, it would remain constant until paid.

KASHIWA, *Judge*, concurring in part and dissenting in part:

I do not agree with the 10 percent royalty rate used by the majority. I also believe that the methodology used by the majority to arrive at that rate is not proper. Rather, it is my opinion that the graduated rate recommended by the Government is the proper rate.

This court has held that where the patentee has by agreement established a royalty rate, that established rate is the measure of reasonable and entire compensation under 28 U.S.C. § 1498 (1970). In *Calhoun* v. *United States*, 197 Ct. Cl. 41, 55–56, 453 F. 2d 1385, 1393–1394 (1972), this court held as follows:

> A. Claimants prefer to have compensation fixed by the Government's cost-savings attributable to the invention; this has been found to be about $0.73 for each use. We agree, however, with the commissioner that while this court has, at times, looked to cost savings in determining compensation (*Shearer* v. *United States*, 101 Ct. Cl. 196, 60 USPQ 414, *cert. denied*, 323 U. S. 676 (1944); *Olsson* v. *United States*, 87 Ct. Cl. 642, 25 F. Supp. 495, 37 USPQ 767 (1938), *cert. denied*, 307 U. S. 621 (1939)), *it has used a reasonable royalty as the basis in all cases where the evidence established a royalty rate used by the patentee in commercial licensing.* * * * Here, the evidence shows that, starting in the 1940's Christensen licensed the patent throughout the industry at a royalty of 0.25 cent for each O-ring used in an infringing structure. Furthermore, Christensen filed in the U. S. Patent Office in 1947, for announcement to the public, a form of license by which he offered to license the patent to anyone at a

> royalty of 0.25 cent per "packing construction." Many licenses were so granted; and between 1946 and 1956, Christensen and his successors were paid royalties by commercial users at the rate of 0.25 cent per O-ring for 261,938,168 infringing structures. See *Calhoun* v. *State Chem. Mfg. Co.*, 153 F. Supp. 293, 115 USPQ 120 (N.D. Ohio 1957). *Thus, the patentee established a royalty which he deemed to be appropriate for use of the invention; and that royalty should form the basis for determining the compensation due plaintiffs.* [Citations omitted; emphasis supplied.]

See also *Carley Life Float Co.* v. *United States*, 74 Ct. Cl. 682 (1932); *Saulnier* v. *United States*, 161 Ct. Cl. 223, 314 F. 2d 950 (1963); *Badowski* v. *United States*, 150 Ct. Cl. 482, 278 F. 2d 934 (1960); *Pitcairn* v. *United States*, 212 Ct. Cl. 168, 547 F. 2d 1106 (1976). For convenience the above rule will be hereinafter referred to as the *Calhoun* rule. The rationale behind the rule is that where the patent owner voluntarily grants a license for consideration, it is only logical to conclude that he considers the consideration to be reasonable. It is a simple and just rule.

The *Calhoun* rule is also easy to apply. So in this case if it is shown that plaintiff, the patent owner, granted a license or licenses to others for consideration within the time frame relevant to this case, the royalty rate so established must be used to compute reasonable and entire compensation under 28 U.S.C. § 1498. Proof that plaintiff voluntarily granted three such licenses in this case is not only uncontradicted but admitted by plaintiff. Unfortunately, there has been a misinterpretation of the effect of the licenses because the label "royalty free cross license" is used to describe these licenses. I refer to portions of the majority opinion wherein these misinterpretations are apparent. The majority in the first sentence of Part II in its opinion states:

> The parties are in agreement that plaintiff *has no established licensing program or royalty applicable* to the patents in this accounting. [Footnote omitted; emphasis supplied.]

The majority reiterates what the trial judge states in his opinion. However, I believe the majority's amendment to the trial judge's Findings of Fact 5 to be inconsistent with

this statement. The majority's change to Findings of Fact 5 is as follows:

> 2. In finding 5, insert the following after the first sentence: "However, the plaintiff granted to the Western Electric Company and RCA a *royalty-free license* in its patents in return for a license in certain groups of patents of those firms. Plaintiff also licensed the Hewlett-Packard Company, a major competitor, with a *royalty-free cross-license* in all patents of each firm." [Emphasis supplied.]

By cross licenses plaintiff granted RCA, Western Electric and Hewlett-Packard the right to use plaintiff's patents in return for plaintiff's right to use their patents. The quid pro quo was the license each company exchanged. Therefore, if the licenses granted to plaintiff can be valued, their respective values, in turn, would establish the royalty value of plaintiff's license herein issue. This court must then, under the *Calhoun* rule, use the established rate to compute reasonable and entire compensation. In analyzing the cross license arrangement between plaintiff and RCA, Mr. Glassman, the expert Government witness, succinctly phrased it:

> * * * under the royalty-free cross license, which included a royalty-free license to RCA under the Plaintiff's oscilloscope patents, RCA was giving up in return the opportunity to receive an effective royalty of 1.375 percent from the Plaintiff, and the Plaintiff was therefore in effect licensing RCA at an effective royalty rate of 1.375 percent of the Plaintiff's own sales. [Tr. 3876.]

In other words, in a royalty free cross license consideration passes between the parties. If the consideration is reduced to monetary terms, the established royalty of plaintiff's license to RCA, Western Electric or Hewlett-Packard may be effectively determined.

Plaintiff, by entering into cross license agreements with RCA, Western Electric and Hewlett-Packard, evaluated its own license; that value should now bind the plaintiff in the instant reasonable and entire compensation determination. Plaintiff's contracts with RCA, Western Electric and Hewlett-Packard should bind plaintiff as the .25 cent per O-ring license bound the patent owner in *Calhoun* and the

2 percent United license bound the patent owner in *Pitcairn, supra.* In *Pitcairn* this court decided the effective royalty rate under aircraft patents there in issue mainly on the 2 percent United agreement voluntarily entered into by plaintiff-patent owner in that case. The court focused upon the United 2 percent agreement even though it was the only reliable agreement outstanding. This court held as follows:

> It is a truism that patents can change or decline in value, and that seems to have been the case for Autogiro, even in its own eyes, during the post-war years. It wanted a package deal for any and all of its patents, and some of these were expiring from time to time. Engineering data for autogiros (manufactured in the pre-war era) were not useful for helicopters (the article made after the war). The post-war procurement of devices using plaintiff's inventions was bound to be very much larger than the pre-war purchases—and the royalty *rates* could therefore decline significantly. Nor is it a sign of invalidating compromise that, especially where a packet of patents is involved, there may have been some doubts as to the validity of some of the claims. Autogiro probably had some of those doubts itself and adjusted its demands accordingly. *For these reasons the 2% United agreement seems to us highly probative under the rule we reiterated in Calhoun v. United States, 197 Ct. Cl. 41, 55–57, 453 F. 2d 1385, 1393–94 (1972). Calhoun* teaches that the mere surmise that a bargained license may possibly include some discount for litigation-avoidance does not *per se* preclude use of an accepted commercial rate as establishing reasonable and entire compensation. *Earlier, Saulnier v. United States, 161 Ct. Cl. 223, 314 F. 2d 950 (1963), took heavy account, in setting compensation, of the plaintiff's previous settlement of infringement claims against the British government where that settlement appeared to be satisfactory and reasonable. See 161 Ct. Cl. at 226–27, 314 F. 2d at 951–52.* [Footnote omitted; emphasis supplied.] [212 Ct. Cl. at 184–86, 547 F. 2d at 1117–18.]

In the instant case, there are three royalty agreements outstanding, but the majority elects to perfunctorily dismiss them as not relevant. They did not even refer to the *Calhoun* rule in summarily avoiding the three cross licenses. However, the Government's expert witness, Mr. Glassman, used these three cross licenses and testified that

in his opinion the royalty rate in this case should be as follows:

1.5 percent on the first $2 million,
1.2 percent on the next $3 million, and
1 percent on the remainder.

The majority rejected Mr. Glassman's rates. It appears that the majority in taking that position did not seriously consider the three cross licenses by plaintiff with RCA, Western Electric and Hewlett-Packard, apparently because these licenses were labeled royalty free cross licenses. The following reasoning given by the majority at p. 266 bears this out:

> The Government's proposal is rejected because the evidence on which it is premised is *not at all analogous* to the facts here. Defendant relies on the licensing programs of RCA and Western Electric but it seems clear that plaintiff—*which was not a company comparable in size to those corporate giants, nor possessed of either a comparable patent portfolio or a comparable product line, nor under the spur of an anti-trust decree—should not be governed by the same considerations.* Items such as transistors, tubes, and similar electronic components are *comparatively simple in structure, have a relatively low per-unit cost, and are sold and used in very large quantities.* Plaintiff's oscilloscopes, on the other hand, are much more complex, have a much higher per-unit cost, and the quantities sold are much lower. [Footnote omitted; emphasis supplied.]

The majority intimates that the percentages presented by the Government have no relevance to plaintiff's oscilloscope patents. But as shown below, the three cross licenses were tied into plaintiff's oscilloscope patents by the testimony of defendant's expert witness. Furthermore, the majority's reference to the irrelevancy of transistor tubes in this litigation shows that the majority did not consider the portion of the record in this case in which the defendant's expert witness analyzed the transistor license values; transistor values were tied into plaintiff's license of its oscilloscope patents by the cross licenses. Nevertheless, corporate sizes, patent portfolio sizes, anti-trust decrees, simplicities of transistors, volumes of sales and complexities of oscilloscopes are all of no relevance under the

Calhoun rule where it is shown that plaintiff by its three cross license agreements established a royalty for its patents.

Mr. Glassman showed that from 1953 up to September 1, 1957, plaintiff was a licensee under RCA's licenses which covered measuring and testing devices (Tr. 3812). Licenses for measuring and testing devices included patents on oscillographs. Plaintiff actually paid RCA royalties for these RCA licenses from 1953 to 1957; this was shown by royalty reports made by plaintiff to RCA. (Defendant's Ex. DA–31E, F and G.) The royalty plaintiff paid RCA in said years was based on 1.5 percent for commercial units but 1 percent for Government sales (see Ex. DA–31D). On September 1, 1957, plaintiff and RCA entered into a cross licensing agreement (Ex. DA–31D) (Tr. 3874). Mr. Glassman considered the prior payments to RCA by plaintiff to establish the reasonable royalty value of plaintiff's patents under the cross license.

As for the plaintiff-Western Electric cross license, Mr. Glassman showed that Western Electric owned patents on transistors which plaintiff used in the manufacture of its oscillographs. Plaintiff found the use of these patents necessary. Western's patents on the transistors were licensed to plaintiff by Western Electric. The rates on these one-way Western Electric to plaintiff transistor licenses were high; so plaintiff negotiated a lower, 1.5 percent, rate in exchange for royalty free use of plaintiff's patents by Western. This was the Western Electric-plaintiff cross license (Tr. 262, 264, 270). Defendant's witness also used the value of royalties on the transistor patents owned by Western Electric to establish the values of royalties on plaintiff's patents in issue in this case.

No one questioned Mr. Glassman's expertise in the field of royalty rates on patents, especially in the electronics field. His testimony covered 219 pages (Tr. 3773 to 3992). In *Pitcairn, supra,* his qualifications are fully listed at 219–20. I do not think it necessary to repeat his qualifications. In the instant case, Mr. Glassman testified that in establish-

ing his graduated royalty rate, starting with 1.5 percent, he considered eight elements which I list in the margin.[1]

I feel that the majority, when they rejected the above-quoted rates suggested by the Government, were overly influenced by plaintiff's profits. They stated at 266:

> * * * Moreover, the evidence is that during the 1960's, plaintiff was realizing on its commercial sales an average profit of 23.7% on the 535 scope and 27.7% on the 545 scope, those figures reflecting plaintiff's margin on these products after both direct and indirect costs had been considered. In view of those figures, defendant's suggestion that plaintiff should be forced to accept a declining royalty starting at 1½% for its inventions could not, without the greatest difficulty, be accepted as just compensation for use of the patents.

The majority's view above expressed conflicts with *Mitchell* v. *United States*, 267 U. S. 341 (1925), the leading case in the federal law of eminent domain on the subject whether business profits may be used as evidence in an eminent domain proceeding to determine reasonable compensation. In *Mitchell* v. *United States, supra*, at 345, the Court held:

> * * * The settled rules of law, however, precluded his considering in that determination consequential damages for losses to their business, or for its destruction. *Joslin Manufacturing Co.* v. *Providence*, 262 U. S. 668, 675. Compare *Sharp* v. *United States*, 191 U. S. 341; *Campbell* v. *United States*, 266 U. S. 368. No recovery therefor can be had now as for a taking of the business. There is no finding as a fact that the Government took

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[1] Mr. Glassman based his testimony on eight criteria:

"Yes. I believe that there are eight pertinent criteria to be used here in determining a reasonable royalty. The first one is the degree of importance, or the advance over the prior art, to put it a little differently, of the patents on which the compensation is to be based.

"Second, the total volume of infringing procurement. Third, the portion of the device which utilizes the patents held valid and infringed. Fourth, whether the royalty base is to be the entire device or only a portion of it. Fifth, the features of the device or related items, such as accessories and data, whose costs are to be deducted in arriving at the royalty base. Sixth, the Court of Claims decisions, and to a lesser extent the decisions of other Federal Courts, on the determination of reasonable royalty rates. Seventh, any licenses which were granted by the Plaintiff under the patents before the filing of the suit. And finally, eight, typical license agreements on electronic testing and measuring apparatus under patents of other companies." [Tr. 3843–3844.]

the business, or that what it did was intended as a taking. If the business was destroyed, the destruction was an unintended incident of the taking of land. There can be no recovery under the Tucker Act if the intention to take is lacking, *Tempel* v. *United States*, 248 U. S. 121. Moreover, the Act did not confer authority to take a business. In the absence of authority, even an intentional taking cannot support an action for compensation under the Tucker Act. *United States* v. *North American Co.*, 253 U. S. 330.

Mitchell has been followed for 52 years[2] as the federal law of eminent domain: excluding business profits of the condemnee owner to prove reasonable value of the condemned property. The majority argues that *Almota Farmers Elevator & Warehouse Co.* v. *United States*, 409 U. S. 470 (1973), stands for the broad proposition that "basic equitable principles of fairness are the governing consideration in determining just compensation for an eminent domain taking" but I do not think that it permits departure from the *Mitchell* rule. In *Almota* in footnotes 2 and 3, at pages 475–476, the majority Justices of the Court remind the dissenting Justices that *Almota* "is not a case where the petitioner is seeking compensation for lost opportunities." The majority of the Court in *Almota* does not overrule *Mitchell;* rather, it assures the dissenting Justices in footnote 2 that *Mitchell* is still the federal law of eminent domain. Applying the *Mitchell* rule to the present case, defendant did not take plaintiff's business. Defendant took only a nonexclusive license under plaintiff's patents in issue in this case. It was highly improper for the majority to refer to plaintiff's percentage of profit.

In 4 *Nichols, Eminent Domain* (3d ed. rev. 1976), § 12.3121, relating to Profits as criteria of value, it is stated:

[1] Past profits.

If the owner of property uses it himself for commercial purposes, the amount of profits from the business conducted upon the property depends so much upon the capital employed and the fortune, skill and good manage-

[2] See *United States ex rel. T.V.A.* v. *Powelson*, 319 U. S. 266 (1943); *Bothwell* v. *United States*, 254 U. S. 231 (1920). *See also Omnia Commercial Co.* v. *United States*, 261 U. S. 502 (1923); *Price Fire & Water Proofing Co.* v. *United States*, 261 U. S. 179 (1923); *United States* v. *Honolulu Plantation Co.*, 182 F. 2d 172 (9th Cir.), *cert. denied*, 340 U. S. 820 (1950); 4 *Nichols, Eminent Domain* (3d ed. rev. 1976), § 12.3121[1], [2].

ment with which the business is conducted, that it furnishes no test of the value of the property. It is, accordingly, well settled that evidence of the profits of a business conducted upon land taken for the public use is not admissible in proceedings for the determination of the compensation which the owner of the land shall receive. * * * [Footnote omitted.]

[2] Future profits.

The admission of evidence as to anticipated future profits is objectionable, not only upon the grounds stated with respect to past profits, but also on the further ground that such profits are necessarily conjectural. Future profits depend on so many contingencies that an accurate valuation cannot be based thereon. Experience and observation both show that paper future profits are more often illusory than real. [Footnote omitted.]

* * * * *

[3] Capitalization of hypothetical income.

The capitalization of hypothetical income method of valuation has generally been rejected by the courts. In *Matter of City of New York (Blackwell's Island Bridge)*, a leading decision in this area, the court said:

"In regard to the vacant lots, parcel No. 31, a witness was asked what would be the best use to which these lots could be put; he replied: The erection of 'three apartment houses, * * * making each building about 33 feet'. He was then allowed to testify, over objections and exceptions, that the cost of constructing three such buildings would be $75,000, and that the rental value of such buildings would be between $14,000 and $15,000 a year. This was clear error. It involved so much of the elements of uncertainty and speculation as to be inadmissible as proof of any fact. * * *'" [Footnote omitted.]

In view of the *Calhoun* rule, it may not be necessary to discuss plaintiff's hypothetical profit computation using Hickok as the hypothetical licensee. Nevertheless, I make the following interesting observations. The hypothetical method used by the majority was adopted from the approach in *Georgia-Pacific Corp.* v. *United States Plywood Corp.*, 318 F. Supp. 1116 (S.D. N.Y. 1970), *aff'd*, 446 F. 2d 295 (2d Cir.), *cert. denied*, 404 U. S. 870 (1971). The district court clearly stated that the hypothetical method may be employed only where there is no established royalty, citing

a Supreme Court case for support. The district court held at 1121:

> The parties agree that there was no "established" royalty for USP's Weldtex or GP striated. Consequently, it is necessary to resort to a broad spectrum of other evidentiary facts probative of a "reasonable" royalty.
>
> Two of the earlier and typical cases relied upon by both parties are Dowagiac Mfg. Co. v. Minnesota Moline Plow Co., 235 U. S. 641, 35 S. Ct. 221, 59 L. Ed. 398 (1915) and United States Frumentum Co. v. Lauhoff, 216 F. 610 (6th Cir. 1914). In Dowagiac Mfg. Co. *supra*, 235 U. S. at 648, 35 S. Ct. at 224, the Supreme Court said that, where a patentee could not prove lost profits, infringer's profits or *an established royalty*, the patentee could "show the value by proving what would have been a reasonable royalty, considering the nature of the invention, its utility and advantages, and the extent of the use involved." * * * [Emphasis supplied.]

In *Dowagiac Manufacturing Co.* v. *Minnesota Moline Plow Co.* 235 U. S. 641, 648 (1915), the Court stated:

> * * * So, *had the plaintiff pursued a course of granting licenses to others to deal in articles embodying the invention, the established royalty could have been proved as indicative of the value of what was taken,* and therefore as affording a basis for measuring the damages. *Philip* v. *Nock*, 17 Wall. 460, 462; *Birdsall* v. *Coolidge*, 93 U. S. 64, 70; *Clark* v. *Wooster*, 119 U. S. 322, 326; *Tilghman* v. *Proctor*, 125 U. S. 136, 143. But, as the patent had been kept a close monopoly, *there was no established royalty. In that situation it was permissible to show the value by proving what would have been a reasonable royalty, considering the nature of the invention, its utility and advantages, and the extent of the use involved.* * * *

Therefore, even *Georgia-Pacific* does not permit using the hypothetical Hickok profit analysis approach where there is an established royalty shown, as in this case, by plaintiff's three cross licenses. I am also of the opinion that the hypothetical Hickok profit approach used by the majority cannot be used because it is a departure from the federal law of eminent domain. Hickok was an infringer but unlike defendant it was a non-Governmental infringer subject to damages only under 35 U.S.C. § 284 (1970). The history of the use of an infringer's profits to determine a

patent owner's damages under 35 U.S.C. § 284 has been a stormy one.[3] There still remains the question as to what Congress intended when it eliminated infringer's profits in 1946 from section 284. It was thought that *Aro Manufacturing Co.* v. *Convertible Top Replacement Co.*, 365 U. S. 336 (1961), resolved the ambiguity but *Georgia-Pacific* was one of the first cases to hold that *Aro* did not eliminate use of infringer's profits to compute reasonable royalty by means of a "willing buyer-willing seller" hypothetical negotiation. See a discussion of this 1946 change in 3 *White, Patent Litigation: Procedure & Tactics* (1976), § 9.01[2]. White, at page 9–34, warns that use of the infringer's profits under the *Georgia-Pacific* approach has resulted in "unusually high" awards in comparison to older cases. He also warns, at pages 9–24 to 9–25, that this infringer's profit approach may again raise questions of allocation or apportionment of infringer's profits under *Dowagiac Manufacturing Co.* v. *Minnesota Moline Plow Co., supra,* and *Westinghouse Elec. and Mfg. Co.* v. *Wagner Elec. and Mfg. Co.*, 225 U. S. 604 (1912), and the "entire market" doctrine. White definitely tags the hypothetical approach in *Georgia-Pacific* as an anticipated profit approach. At page 9–33 he states:

> Although the concept of the infringer's profits does become involved in determining a reasonable royalty, it should be observed that the point of interest is not the profit which actually was realized but that which was anticipated. The *Georgia-Pacific* case illustrates the point, for G–P apparently contended that the market for the products involved in the suit, and presumably their profitability, decreased during the period of infringe-

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[3] See *Hearings on H.R. 5231* (later reported as H.R. 5311) *Before the House Comm. on Patents*, 79th Cong., 2d Sess. 2–3 (1946) (remarks of Rep. Henry explaining the prime reason for the elimination of infringer's profits):

"Now, however, by far the greater number of patents that are in litigation are on special and often relatively insignificant parts of complex structures to which the patented feature is so related that it is absolutely impossible to apportion the profits due to the invention, those being the only profits to which the patentee is entitled.

"The result is that there is a complete failure of justice in almost every case in which supposed profits are recovered or recoverable.

"Absolutely artificial and unsound rules have been invented to solve the impossible problem of how to apportion profits."

Portions of the hearing, including the above quotation and other pertinent information, are quoted at length in footnotes in *Georgia-Pacific Corp.* v. *United States Plywood Corp.*, 243 F. Supp. 500, 521–527 (S.D. N.Y. 1965).

> ment. The court, however, emphasized the situation at the time the reasonable royalty would have been negotiated, and relied on the anticipated profits rather than those actually realized. [Footnotes omitted.]

I submit that since in *Georgia-Pacific* damages were assessed under 35 U.S.C. § 284, the limitations in establishing market value under the federal law of eminent domain were not considered. As shown above, the *Mitchell* rule which prescribes the use of profits as a measure of damages also limits use by this court of the hypothetical Hickok profit approach. The majority's sole statutory authority for allowing plaintiff compensation is 28 U.S.C. § 1498, under the federal law of eminent domain. Therefore, *Mitchell* applies and prevents such a hypothetical profit approach.[4]

In addition, the following "apportionment rule" prevents the use of the Hickok hypothetical profit approach. In *Westinghouse Elec. and Mfg. Co.* v. *Wagner Elec. and Mfg. Co., supra,* involving an electrical converter to promote the efficiency of transformers, the Court stated at 614–615:

> (d) But there are many cases in which the plaintiff's patent is only a part of the machine and creates only a part of the profits. His invention may have been used in combination with valuable improvements made, or other patents appropriated by the infringer, and each may have jointly, but unequally, contributed to the profits. In such case, if plaintiff's patent only created a part of the profits, he is only entitled to recover that part of the net gains. He must, therefore, "give evidence tending to

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[4] The majority in its footnote 7 states that:

"This willing-buyer/willing-seller technique in determining a reasonable royalty has not been a stranger to the Court of Claims. *Olsson* v. *United States, supra; Badowski* v. *United States,* 150 Ct. Cl. 482, 485, 278 F. 2d 934 (1960); *Ushakoff* v. *United States,* 179 Ct. Cl. 780, 785–86, 375 F. 2d 822, 825, 153 U.S.P.Q. 410 (1967); *Amerace Esna Corp.* v. *United States,* 199 Ct. Cl. 175, 462 F. 2d 1377, 174 U.S.P.Q. 517 (1972). For cases from other courts, *see, e.g., Jenn-Air Corp.* v. *Penn Ventilator Co.,* 394 F. Supp. 665, 185 U.S.P.Q. 410 (E.D. Pa. 1975)."

None of the Court of Claims cases uses the infringer's profit hypothetical approach. *Olsson* uses the willing buyer-willing seller approach using Government savings as a basis. In *Badowski* the willing buyer-willing seller approach was used using prior commercial licenses granted by the patent owner as a basis. In *Ushakoff* the willing buyer-willing seller approach was implemented using prior commercial licenses as a basis. *Amerace Esna Corp.* uses the willing buyer-willing seller approach using cost savings to defendant as a basis. *Jenn-Air Corp.* uses the willing buyer-willing seller approach but it was a damage determination under 35 U.S.C. § 284 and a suit between private parties; the federal rules of eminent domain are not applicable in such cases.

separate or apportion the defendant's profits and the patentee's damages between the patented feature and the unpatented features, and such evidence must be reliable and tangible, and not conjectural or speculative; or he must show, by equally reliable and satisfactory evidence, that the profits and damages are to be calculated on the whole machine, for the reason that the entire value of the whole machine, as a marketable article, is properly and legally attributable to the patented feature." *Garretson* v. *Clark*, 111 U. S. 120.

The Government's expert witnesses described plaintiff's patent as only an improvement patent (Tr. 3863) and plaintiff's own witnesses deposed that plaintiff's patents were improvement patents. Oscillographs were in use prior to and during World War II, before plaintiff's patents were ever in the picture. In fact, Jetronic Industries, Inc. was already in the business of manufacturing oscillographs before plaintiff's improvement patents were obtained. The war itself generated a tremendous amount of basic research in electronic circuitry, much of it financed under wartime Government contracts. Much of this basic work, performed at Radiation Laboratory at the Massachusetts Institute of Technology, related to the wartime need for improved radar and fire control systems. This pioneering work generated a large postwar spinoff in the form of a growing civilian electronics industry. Some of this basic work at the Massachusetts Institute of Technology Radiation Laboratory produced two basic oscilloscope patents to Chance and Washburn owned by the Government, which have previously been the subject of controversy in this case. *Tektronix, Inc.* v. *United States*, 173 Ct. Cl. 281, 351 F. 2d 630 (1965) [DA3–44, DA3–47, DA3–21A, DA3–21B]. These patents are fundamental to the accused oscilloscopes and are cited as prior art references in many of the patents in suit [DA3–34, DA3–35, DA3–45, DA3–46, DA3–48, DA3–49, see deposition of Gunnar P. Ohman, DA3]. In this environment of radically changing technology during a period of tremendous growth for the entire electronics field, the plaintiff corporation was founded by Howard Vollum in 1946 specifically to design and ultimately to manufacture improved oscilloscopes. *Tektronix, Inc.* v. *United States*, 188 USPQ 25, 27 (Ct. Cl. Tr. Div., 1975);

Finding 3. It is undisputed that during the period from 1946 to 1954, the plaintiff developed several improved circuits which, taken together, produced a technically advanced oscilloscope. *Id.* However, it is also clear that much of this improved circuitry was based on the Government's wartime research work which had been generally made available to the public at large [DA3–46, DA3–49, see generally DA3].

In the second *Georgia-Pacific* district court decision, reported in 318 F. Supp. 1116, the court held at 1132:

> [6] This case does not permit application of the principle of apportionment inasmuch as the Deskey patent was not one for an improvement on an article nor was GP's infringement of a patented feature sold together with unpatented parts. Decisions illustrating the rule applicable to patented improvements or to patented parts of articles also embodying unpatented parts are not apposite for the reason that the Deskey patent covered and Weldtex represented a marketable article—a panel of striated fir plywood—as an entirety.
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> * * * * *
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> In terms of a structural test, for example, the contribution of the Deskey invention cannot be isolated as a separate physical part. The invention permeated the plywood panel to such a degree that it should be considered as covering the article as a whole. In this situation, the invention was not only for an improvement.

The article involved in *Georgia-Pacific* was plywood so it could be said that the invention "permeated" the plywood panel, but the present case is like the transformer improvement patent in *Westinghouse Elec. and Mfg. Co.* v. *Wagner Elec. and Mfg. Co., supra,* where the Court recognized that electrical equipment is fundamentally made of many parts. The majority revived the much-feared problem of allocation of infringer's profit, which Congress attempted to eliminate (see *supra,* footnote 3). The Chance patent and the Washburn patent owned by the Government were recited as prior art in the patents involved in the present case, and the said Government-owned patents were fundamental to the accused oscilloscopes. The mere fact that in *Tektronix, Inc.* v. *United States,* 173 Ct. Cl. 281,

this court held that these two Government patents were not subject to counterclaim damages by the Government does not mean that under the *Westinghouse Elec. and Mfg. Co.* apportionment rule, this court need not apportion values attributable to the Chance and Washburn patents in computing eminent domain compensation under 28 U.S.C. § 1498. I believe that *United States* v. *Fuller*, 409 U. S. 488 (1973), is a leading eminent domain case for the proposition that the Government in a condemnation case may not be required to compensate a condemnee for elements of value that the Government has created. In *Fuller* the alleged added value was by 31,461 acres of Government-owned grazing lands adjacent to the condemnee's ranch property of 1,280 acres owned in fee simple by the condemnee. In *Fuller*, at pages 492–493, the Court said:

> These cases go far toward establishing the general principle that *the Government as condemnor may not be required to compensate a condemnee for elements of value that the Government has created, or that it might have destroyed under the exercise of governmental authority other than the power of eminent domain.* If, as in *Rands* [389 U. S. 121 (1967)], the Government need not pay for value that it could have acquired by exercise of a servitude arising under the commerce power, it would seem *a fortiori* that it need not compensate for value that it could remove by revocation of a permit for the use of lands that it owned outright.
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> * * * * *
>
> We hold that the Fifth Amendment does not require the Government to pay for that element of value based on the use of respondents' fee lands in combination with the Government's permit lands.

I submit that the Chance and Washburn patents added value to plaintiff's patent, as were the Government-owned grazing lands added value to Fuller's land. The grazing charges for those grazing lands were very minimal, virtually free.

With relation to the "entire market value rule" which the majority has suggested and used to avoid the apportionment of infringer's profits under the *Westinghouse* rule, I answer by quoting from *Marconi Wireless Telegraph Co.* v.

United States, 99 Ct. Cl. 1, 46–47 (1942), modified on other grounds, 320 U. S. 1 (1943), where it is stated:

> The status of a patent in the art with which it is associated is of importance in determining the base which is to be used in an accounting. The reason for this is succinctly set forth in *Garretson* v. *Clark*, 111 U. S. 120, in which it is stated:
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> > When a patent is for an improvement, and not for an entirely new machine or contrivance, the patentee must show in what particulars his improvement has added to the usefulness of the machine or contrivance. He must separate its results distinctly from those of the other parts, so that the benefits derived from it may be distinctly seen and appreciated. The rule on this head is aptly stated by Mr. Justice Blatchford in the court below: "The patentee," he says, "must in every case give evidence tending to separate or apportion the defendant's profits and the patentee's damages between the patented feature and the unpatented features, and such evidence must be reliable and tangible, and not conjectural or speculative; *or he must show*, by equally reliable and satisfactory evidence, *that the profits and damages are to be calculated on the whole machine, for the reason that the entire value of the whole machine, as a marketable article, is properly and legally attributable to the patented feature.*" [Italics ours.]
>
> From a consideration of subsequent cases, the application of this rule relates more directly to an accounting based upon profits rather than the type of accounting which is based on reasonable royalty and which has been followed in the present case with reference to the Lodge patent. *This becomes apparent if we consider a theoretical instance, in which the profits, due to the patented portion of a machine, have on apportionment been found to be 25 percent of the total profits on the machine, the remaining 75 percent being due to extraneous elements or elements patented by others. In such a case plaintiff would be entitled only to the profits on the features or elements covered by his patent.* If, however, the recovery of compensation in the same instance were measured by a reasonable royalty, such a procedure would take into consideration both the nature of the patented invention and its relation to the entire machine as a whole. Thus, in applying a reasonable royalty rule to the same situation just outlined, the differential between the patented and unpatented features of the machine would

> be taken into account by scaling down the percentage of royalty accordingly. It would make no difference in the ultimate compensation to plaintiff if the reasonable royalty were fixed at 5 percent of the selling price of the complete machine rather than 20 percent of one quarter of the sales price of the machine. [Emphasis supplied.]

In the present case, in its attempt to establish a royalty rate of a "willing-buyer/willing-seller," the majority uses and depends on an accounting which is based upon profits of Hickok. Under the above-quoted passage from *Marconi*, before the majority can construct a hypothetical profit figure for Hickok, the majority must apportion the hypothetical profits between profits generated solely by plaintiff's oscillograph patents and profits attributable to "extraneous elements or elements patented by others." In determining the "willing-buyer/willing-seller" royalty rate, the majority may use only the portion of Hickok's profits allocable to plaintiff's patent; the majority may not include profits allocable to *"extraneous elements or elements patented by others."* The "entire market value rule" may not be used to establish a rate which is based on unapportioned profits. Therefore, by using the unapportioned profits of Hickok without first segregating that portion of Hickok's profits allocable to plaintiff's patents from that portion allocable to *"extraneous elements or elements patented by others,"* the majority repudiated the *Marconi* rule. Under the *Marconi* analysis, the majority should have allocated the gross profit figure of $118 between the portion attributable to plaintiff's patents and the other portions attributable to "extraneous elements or elements patented by others." The record shows that patents "by others" in this case include patents by Chance (oscillographs), Washburn (oscillographs), Western Electric (transistors, photo transistors and diodes), RCA (oscillographs) and Hewlett-Packard (oscillographs). In this respect, plaintiff's vice president, Mr. Weber, testified that the Western Electric, Hewlett-Packard and RCA patents were material considerations in plaintiff's cross license agreements. Mr. Glassman testified that an application of the lost profit theory in this case would be inappropriate because

> * * * there was considerable uncertainty about what the Plaintiff's profits would have been even if they had been capable of accepting these contracts, and I have already referred *to the impracticality of trying to determine the exact costs of those parts of the oscilloscope which used the patents* in suit. So all these things put together, it seems to me, indicate that the lost profits theory is quite inappropriate. [Emphasis supplied.] [Tr. 3884.]

Therefore, I submit that in order to be consistent with the *Calhoun* rule and *Saulnier, supra, Badowski, supra,* and *Pitcairn, supra,* where a royalty rate is established by plaintiff's own cross licenses, that royalty rate established is the measure of reasonable and entire compensation. The total recovery computed using such established rate should not be summarily upset or changed by comparing the final figure to plaintiff's total profits or rate of profit from plaintiff's business, as the majority did. Plaintiff's business profits should not be an element in establishing plaintiff's recovery because defendant did not take plaintiff's business. We must not depart from *Mitchell* v. *United States, supra.* Under the *Calhoun* rule, in view of the existence of an established royalty determined by reference to the three cross licenses between plaintiff and RCA, Western Electric and Hewlett-Packard, the Government's suggested graduated rate, 1.5 percent on the first $2 million, 1.2 percent on the next $3 million and 1 percent on the remainder, should have been accepted by the majority.

I submit that use of the Hickok hypothetical profit approach by the majority was in error. Even *Georgia-Pacific* discusses the necessity of considering apportionment of infringer's profits (Hickok) where the patent in issue is only an improvement patent; the majority, however, did not take up this problem of apportioning Hickok's gross profit figure of $118. Defendant's witness testified that if the Hickok profit were apportioned, the resulting rate would be much less than the 7.65 percent rate selected by the majority (Tr. 3908).

I submit that a willing buyer-willing seller approach using a hypothetical infringer's profits as a basis of analysis is not only novel but without precedent in a suit under 28 U.S.C. § 1498 governed by the federal law of

eminent domain. I submit that the majority erred in using the infringer's profit approach for the reasons above stated.

Under the Government's graduated rate, plaintiff is entitled to recover $185,445. ((Tr. 3845), Ex. DA-25, -26 - 27A.) As for the method of compensating delayed compensation, I agree with the majority.

FINDINGS OF FACT

The court, having considered the evidence, the findings of former Trial Judge Hal D. Cooper, and the briefs and arguments of counsel, makes findings of fact as follows:

1. The oscilloscopes (hereafter scopes) for which plaintiff seeks compensation are the following models: 1805, 1805A, USM/81, LA261, LA265, LA265A, LA545, AN/USM-105, AN/USM-140 series, and AN/USM-141 series.

2. All of the scopes here in issue are covered by one or more claims of one or more of the patents in suit. The patents in issue cover only portions of the accused scopes. None of the patents cover the preamplifier units, referred to as plug-ins, used with the scopes and scopes can be purchased without plug-ins; however, the scope has no utility without a plug-in and the practice most often followed is to order plug-ins from the same source as the scopes. The plug-ins are financially dependent on the market created by the patented scopes. Patent No. 2,883,619 is directed to an electrical probe. Plaintiff's evidence is insufficient to make any determination with respect to the probes.

3. Plaintiff's 535 and 545 scopes which embody the circuitry disclosed and claimed in the patents here in suit were the culmination of 7 years of research and development and were first offered for sale in 1954. Up to the time of the liability trial in 1965, plaintiff had sold more than 26,000 type-535 and more than 40,000 type-545 scopes producing revenues in excess of $100 million. The inventions of the patents in suit made a substantial contribution to oscilloscope technology, increasing the reliability and precision of measurements made with scopes and making it possible to do jobs which were practically impossible otherwise. Despite attempts by others to produce high-performance oscilloscopes with Government funding, plaintiff's scopes employing the patented circuitry in suit were the most technically advanced scopes available in 1958 and for several years thereafter. Oscilloscopes which did not have the patented circuitry were technically obsolete after

introduction of the patented scopes. The wide range of sweep speeds and the plug-in versatility of plaintiff's scope made it possible to replace two or more older scopes or other instruments with one patented scope. No one else was able, in the late 1950's and early 1960's to manufacture a competitive scope of the same high performance and technical sophistication as plaintiff's scopes without using the patented circuitry.

4. (a) Defendant was not interested in procuring a scope which the third-party defendants designed and built. Defendant's procurement procedure made it clear that it would accept only plaintiff's scope or a virtual copy thereof manufactured by one of the third-party defendants. In its early requests and invitations, defendant described the product it was seeking in language such as "Tektronix, Inc. Model 535 as manufactured by Hickok," "Jetronic Model to meet characteristics of Tektronix Model 535," "Tektronix Model 535 or equal," or "Tektronix Model 545 or equal." Later, when the third-party defendants had their own nomenclature describing their copy of plaintiff's scopes, defendant's requests were phrased in the alternative such as "Tektronix 545A or Hickok 1805A or Lavoie LA265A."

(b) In order to meet defendant's requirements, Jetronics found it necessary to copy the physical layout and circuit design of the Tektronix 535 and used the Tektronix 535 performance specifications in manufacturing the USM/81. To comply with defendant's requirements, Hickok copied the physical layout and circuit design of the Tektronix 535 in manufacturing its USM/81. Likewise, to meet defendant's requirements, Hickok manufactured its 1805 as a copy of the Tektronix 545. On at least one occasion, in competing against plaintiff for a contract involving a Tektronix 545A-type oscilloscope, Hickok actually submitted to defendant a Tektronix-manufactured oscilloscope with a Hickok face plate and represented the scope as a bid sample of the scope that Hickok intended to manufacture. The three Lavoie scopes LA545, LA265, and LA265A are essentially the same instrument. No distinction was made by the court during the liability trial and the LA265 was considered representative of all. A comparison of the LA265 scope with the Tektronix 545A scope shows that the scopes are virtually identical in appearance and internal structure. A comparison of the LA261 scope and the LA261 manual with plaintiff's 516 scope and plaintiff's manual shows that the Lavoie LA261 is a copy of the Tektronix 516 in structure, appearance, specifications, and that in all material respects the two are identical. In addition to copying the mainframes of the scopes, both

Hickok and Lavoie copied plaintiff's plug-in components which are inserted into the mainframe of the scope as part of the integral structure of the scope. Lavoie even used the same nomenclature as plaintiff to designate its plug-ins.

(c) Because the copies of plaintiff's instruments so closely resembled genuine Tektronix instruments, many of defendant's employees thought the copies were made by plaintiff. When problems arose with the copies, plaintiff's field engineers were often called to fix the instruments. When they were called upon by defendant's employees and asked for assistance, plaintiff's field engineers usually assisted defendant and provided information, service, and even repaired some of the copies of plaintiff's instruments. Often it was only after having made a special trip to a Government installation that plaintiff's field engineer realized he had been asked for assistance relating to a non-Tektronix instrument. Some employees of defendant asked plaintiff's field engineers for assistance relating to the copies even after realizing that the instruments were not made by plaintiff when they were unable to get help from the third-party defendants. Plaintiff's field engineers and instructors conducted training classes on plaintiff's instruments, many of which were attended by military personnel who then used the copies of plaintiff's instruments manufactured by Hickok or Lavoie. On some occasions, plaintiff's field engineers, at defendant's request, drove great distances to remote military installations to teach military personnel how to use plaintiff's instruments, only to find that mainly copies were being used.

(d) Plaintiff's commercial scopes could have satisfied defendant's needs for the USM/81, 1805, 1805A, LA545, LA265, LA265A, and LA261 types of scopes. The AN/USM–105 and the AN/USM–140 and 141 series were militarized versions which plaintiff did not make and on which plaintiff did not seek to bid.

5. Although plaintiff has a policy of actively seeking patent protection for its inventions, it does not use its patent portfolio for the purpose of producing revenue by licensing; rather, it employs patents to protect its market position as a leading manufacturer of oscilloscopes. However, the plaintiff granted to the Western Electric Company and RCA a royalty-free license in its patents in return for a license in certain groups of patents of those firms. Plaintiff also licensed the Hewlett-Packard Company, a major competitor, with a royalty-free cross-license in all patents of each firm. The few instances in which plaintiff did enter into licenses, and the unique circumstances surrounding those licenses, lead to the conclusion that

plaintiff has no discernible licensing policy upon which this court can predicate a "reasonable royalty." Defendants concede this to be the fact.

6. Extensive testimony by Mr. E. E. Swanson, controller for plaintiff since 1961, as well as by others, has satisfactorily established plaintiff's sales, its accounting procedures and methods, its cost-accounting techniques, its discount policies, its catalog prices, and, where necessary, the reason for the absence of certain records and the basis on which certain subsidiary records may be used to ascertain the needed information. This evidence establishes that:

(a) Plaintiff's policy was to sell its oscilloscopes to all customers, including defendant, at the catalog price less its standard discount. That discount policy provided no discount on the first nine units purchased, a 2% discount on the tenth unit through the twenty-fourth, a 4% discount for the twenty-fifth unit through the forty-ninth, and a 6% discount on all units beyond the forty-ninth. Plaintiff's catalog prices, which remained the same at all relevant times, were $1,400 for the 535, $1,550 for the 545, and $1,130 for the 516.

(b) Plaintiff's costs to produce scopes consist of material, labor, variable burden, and fixed burden. Fixed burden is the burden that does not vary with the volume of production but varies with or is related to a period of time. Fixed burden includes the capacity expenses and direct-period expenses of nonmanufacturing areas. Capacity expenses are the expenses associated with a general level of production or an ability or capacity to operate or produce at a certain level. Depreciation, insurance, and property taxes are capacity expenses and thus are part of fixed burden. Marketing, administration, and engineering expenses are direct period or fixed expenses and thus part of fixed burden.

(c) Other possible costs that may be incurred are expenses in making a sale, shipping, warehousing, field support, order processing, billing, carrying higher inventory, and accounts receivable.

(d) The difference between the selling price and the total variable cost or out-of-pocket cost is the contribution which a product makes toward fixed burden and profit.

(e) Sales to defendant have generally been about 10% of plaintiff's total sales. Even including indirect sales, defendant's business has never exceeded 25% of plaintiff's total sales. If defendant had procured from plaintiff all of the nonmilitarized scopes, including plug-ins and accessories, that it procured from the third-party defendants, plaintiff's annual sales would have increased an average of

approximately 3% during the period 1959-1966. The increase would not have exceeded 6% in any year. During the period 1959 to 1968, plaintiff sold 14,230 model 535 or 535A scopes and 20,485 model 545 and 545A scopes.

7. The evidence, including the testimony of plaintiff's witnesses Scott and Park, established that the increase in production required to fill the contracts for nonmilitarized scopes awarded to others could have been handled by plaintiff, with its existing facilities and personnel, either then currently employed or from a readily available labor pool. This was true throughout the period of infringement. The commercial models which plaintiff sold to its other customers would have met the requirements of defendant. However, plaintiff has failed to prove by clear and convincing evidence that, if the defendant had confined itself to authorized sellers, plaintiff would have actually made the sales to the Government which were made by the third-party defendants, or that if it had made such sales it would have made and retained the "lost" profits it seeks in the present suit.

8. Defendant's gross cost for procuring the scopes, plug-ins, accessories, and spares under the 42 contracts was approximately $10,409,730. This represented a savings to defendant of more than $4,891,000, as compared to the cost of the scopes and plug-ins had they been procured from plaintiff. These contracts covered procurement of 9,105 scopes. Based on the scopes only, defendant's procurement cost it $9,115,068, as compared to $12,542,617 at plaintiff's prices, a savings of $3,427,549 for defendant. For scopes and plug-ins together, excluding all else, defendant's procurement costs were $9,740,385.

9. Based on the information available at trial, defendant, under 30 separate contracts, procured 8,437 militarized scopes from Hickok and Lavoie. These procurements were spread over the following period:

Year	*Oscilloscopes*
1961	1,079
1962	645
1963	359
1964	1,609
1965	639
1966	2,607
1967	1,499
Total	8,437

This represented a total procurement of $11,557,695, of which $7,829,772 was the cost of the scopes.

10. (a) Defendants concede there is no established royalty for the patents in this accounting. Defendant relies principally on certain commercial radio apparatus licenses granted by Radio Corporation of America (RCA), which licenses included oscilloscopes as one of the types of apparatus licensed. Plaintiff is a licensee of RCA under this type of license. The RCA license had a commercial royalty rate of 1½% and a Government rate of 1%. Plaintiff also had a cross-license with Western Electric, which had a royalty rate of 2% on commercial sales and 1% on sales to the Department of Defense. Also in evidence is a Raytheon license with defendant which provided a sliding royalty ranging from 2% to 1% on subminiature tubes. Based on these licenses, defendant recommends a royalty program of 1.5% on the first $2 million of procurement, 1.2% on the next $3 million procurement, and 1% on the remainder, with the royalty base restricted to the scope, omitting all plug-ins, probes, accessories, packing, data, etc. Those figures would yield a total royalty of $185,445 for all of the scopes, both military and commercial, procured by defendant.

(b) The RCA, Western Electric, and Raytheon licenses on which defendant relies are not analogous to the situation present here. Each of those companies is, as compared to plaintiff, a corporate giant with a diverse product line and extensive patent portfolios. The licensing program of both RCA and Western Electric was in the context of an antitrust consent decree. The subminiaturized tubes of Raytheon are not in any way related to oscilloscopes. Items such as transistors, tubes, and similar electronic components have a relatively low per-unit cost but are sold and used in large quantity. That is distinguishable from an instrument such as an oscilloscope where the per-unit cost is much higher and the quantities sold are much lower. Defendants have not carried their burden of establishing any meaningful pattern of licenses, or royalty rates, that would be relevant in this case.

11. (a) Plaintiff offered the testimony of Elmer Gorn to assist the court in establishing a reasonable royalty rate to be used in determining the basic compensation due plaintiff for infringement on contracts involving the AN/USM–105, AN/USM–140, and AN/USM–141 scopes. Gorn proposed to establish a reasonable royalty on a "willing buyer-willing seller" model. That model contemplates a supposititious meeting prior to any infringement between the patent owner and the potential manufacturer of the infringing items in order to negotiate a license agreement. The prospective licensee and the prospective

licensor in this hypothetical meeting would agree upon a royalty equal to the difference between the expected sale price and the expected cost of the infringing item minus the normal nonproprietary profit of the infringing manufacturer. In postulating what the potential licensor might suggest during the hypothetical meeting as his expected sale price of the infringing item, the actual sale price of the infringing item may be considered if it is reasonable and consistent with the assumptions and expectations of the parties governing the hypothetical negotiation. Where the patentee has manufactured the patented item and has adequate cost data with respect thereto and where the prospective licensee has not manufactured the patented item, the prospective licensee has not manufactured the patented item, the parties would adopt the patentee's costs as a reasonable estimate of the prospective licensee's costs. Those costs would include all of the factors thought necessary, *i.e.*, materials, labor, variable manufacturing burden, fixed manufacturing burden, marketing expense, administration expense, and research and engineering expenses.

(b) This formula presented by plaintiff, when properly used, furnishes a good starting-point for the determination of a reasonable royalty which would be agreed upon by a "willing buyer" and "willing seller."

12. (a) Cost/price studies were made by plaintiff during the period of 1959–1967. The purpose of these studies was to evaluate the profit performance of each product and to aid in pricing new products. These studies compiled actual manufacturing costs for each product sold by plaintiff; in addition, each product was allocated a certain percentage of the nonmanufacturing costs including research and development, marketing, and administration. The allocation is based on a percentage of the standard manufacturing cost of each product and merely represents a method of spreading these expenses across the entire product line. The "Total Company Cost" is a sum of both the actual costs for each product and the allocated costs assigned to that product. To determine the actual manufacturing costs for that product, the allocated costs should not be included.

(b) Plaintiff's cost for the model –545 scope during 1959 was $1019. That figure is based on the variable manufacturing cost of $486 plus $533 for fixed burden, marketing and administrative costs, etc. (including plaintiff's profit-sharing program).

(c) Hickok's average profit during the period 1960–68 was 2.7%. In 1961, its profit was 4.7% of sales.

(d) Plaintiff has a profit-sharing program in which 35% of the profits each year is distributed to its employees.

13. The result of the formula described in finding 11, when appropriately applied to this case, leaves a residual share of 7.65% of unit price as royalty (or part of the royalty) for the plaintiff as the presumed willing seller. Based on all the considerations applicable to the case it is concluded, however, that 10% would be the reasonable royalty accepted by the supposititious willing seller and willing buyer.

14. (a) Where it is not practicable to determine with certainty the cost of portions of a device, the general practice in the electronics industry is to use the cost of the entire "black box" or device as a royalty base. If only a minor portion of the device is covered by the patent, a lower royalty rate in recognition of this fact is usually adopted. While, in the present case, less than the entire scope is covered by the patents in suit, the patented circuits cover the major elements that make the scope a success so no diminution in royalty would be appropriate.

(b) It is the practice in the industry to negotiate the base to which the royalty rate is to be applied. In some instances, unpatented items such as plug-ins and accessories are included in the base while, in other instances, they would be excluded. There is no exact formula for determining this, the practice varying from license to license. One reasonable approach is to include in the base everything required for an operative device, which, in this case, would include plug-ins, probes, and accessories. Another reasonable approach would be to exclude from the base all unpatented items which are readily separable and for which separate prices are readily ascertainable; this would exclude plug-ins, probes, and accessories. Items such as packing and instruction manuals are not normally included in the royalty base.

15. Hickok presented some cost estimates it had made in early 1961 for an unsuccessful bid on a contract for production of the 1805 scope. No records were produced by Hickok to show either what its actual costs were or what its actual profits were on the sale of these scopes. Nor did Hickok produce any estimated costs for any contracts actually awarded to it.

16. As a part of its periodic cost/price studies, plaintiff projected, for each product, an anticipated profit margin as a percent of the catalog price. During 1961–67, those margins were:

On Rehearing

	Model 535 Percentage	*Model 545 Percentage*
1961	25.7	29.9
1962	21.9	20.7
1963	24.1	28.7
1964	29.6	30.3
1965	20.8	28.3
1966	22.2	26.5
1967	22.0	25.4
Average:	23.7	27.1

The combined average, weighted to reflect the higher sales of the model 545, is 26.5%.

17. At the rate of 10%, applied to a base of $21,298,080 ($9,740,385 for the "commercial" scopes plus plug-in accessories; $11,557,695 for "militarized" scopes plus plug-in accessories), the reasonable and entire compensation to plaintiff for the patents infringed amounts to $2,129,808 plus compensation for delay in payment.

18. Compensation for delay in payment shall be made at the rates prescribed in *Pitcairn v. United States*, 212 Ct. Cl. 168, 547 F. 2d 1106 (1976).

CONCLUSION OF LAW

Upon the foregoing findings of fact which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover the sum of $2,129,808 plus interest as part of just compensation. The exact amount of recovery will be determined under Rule 131(c).

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557 F.2d 265

ORDER ON REHEARING

[June 24, 1977]

Joel R. Feidelman, attorney of record, for plaintiff. *Peter D. Ehrenhaft, Harvey N. Bernstein, Joseph J. Petrillo, Lawrence R. Sidman, Fried, Frank, Harris, Shriver & Kampelman*, and *N. Eric Jorgensen*, of counsel.

Thomas J. Scott, Jr., with whom was *Assistant Attorney General Barbara Allen Babcock*, for defendant. *Vito J. DiPietro*, of counsel.

Before DAVIS, *Judge*, Presiding, COWEN and SKELTON, *Senior Judges*, NICHOLS, KASHIWA, KUNZIG and BENNETT, *Judges, en banc.*

This case comes before the court on defendant's motion for rehearing together with plaintiff's response, and on plaintiff's motion for rehearing together with defendant's response. The court has considered these presentations *en banc*, without oral argument. The motions for rehearing are both denied except to the following extent:

1. The court's opinion of March 23, 1977 and findings are amended to delete the specific figures for the royalty bases for both the "commercial" and the "militarized" scopes.
2. The court's opinion and conclusion of law are amended to delete the figure given for reasonable and entire compensation (before delay compensation).
3. The case is returned to the Trial Division (in addition to the remand already ordered to determine the amount of delay compensation) to recompute, on the basis of the present record, the royalty bases for both "commercial" and "militarized" scopes to include only the scopes themselves and all the plug-ins. In our original opinion we excluded (as had the trial judge) packaging and other miscellaneous costs, and we adhere to that position. We now specifically reject plaintiff's current request for inclusion of probes and carts, on the ground that plaintiff did not adequately, at the time the case was presented to us, ask for the inclusion of those items for either type of scope.

As for the "commercial" scopes, it now appears that the trial judge, in determining the base for that kind of scope to be $9,740,385 (a figure we adopted), may possibly have excluded a substantial number of plug-ins, despite the trial judge's and our intention to include all the plug-ins for the "commercial" scopes. With respect to the "militarized" scopes, it now appears that the base figure of $11,557,695,

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which we accepted from plaintiff's then brief as "the royalty base for militarized scopes including plug-ins", may well cover items which we did not intend to include, such as packaging, miscellaneous costs, probes, and carts.

4. After recomputing the royalty bases, the trial judge will apply to those bases the 10% rate we established in our opinion of March 23, 1977, then determine the delay compensation under Part VIII of that opinion, and finally determine the total award.

5. In carrying out the above computations, the trial judge shall call upon the parties for any submissions or procedures he deems helpful in the expeditious computation of the amount of recovery.

IT IS SO ORDERED.

Judge KASHIWA would deny plaintiff's motion for rehearing but would grant defendant's motion for rehearing.

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552 F.2d 326

EDISON SAULT ELECTRIC COMPANY v. THE UNITED STATES

[No. 400–74. Decided March 23, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Boundary Waters Treaty of 1909; International Joint Commission; control of waterflow in Great Lakes; breach of contract claim.— Plaintiff is a Michigan public utility whose power is mainly derived from a hydroelectric generating plant at the Sault Ste. Marie rapids on the St. Marys River which is a point of passage for water from Lake Superior to Lake Huron and is a boundary with Canada. The plant was built in 1902 by another company and was purchased by plaintiff from an intermediate owner in 1962, plaintiff agreeing to assume all its predecessors' rights and obligations under the original lease and supplemental agreements. Pursuant to the 1909 Boundary Waters Treaty between the United States and Canada, the waters upon which plaintiff's facilities are built are under control of the International Joint Commission (Commission) whose jurisdiction was to be coextensive with its purpose of water control. Plaintiff could only use the waters through Government lease, subject to the Commission's approval. The original

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lease was granted in 1914, and at that time the Commission created an International Lake Superior Board of Control (Board) in order to regulate the elevation of Lake Superior and the outflow of the St. Marys River. During 1972 the Great Lakes area was subject to heavy rains and flooding; in November 1972 Congress requested the Executive Branch to take steps to relieve the high water levels in the lower Great Lakes, in part by reducing outflow from Lake Superior; on January 30, 1973 the Commission directed the Board to reduce Lake Superior outflow from 71,000 to 55,000 c.f.s. for a 3-month period. At the time of reduction of flow, the water level in Lake Superior was within the levels specified by the Commission's orders of approval of 1914 and regulations subsequently promulgated by the Board. Successive reductions in waterflow through plaintiff's plant were ordered on February 2, March 22, April 30 and May 29, 1973. However, the flow of water to United States-owned hydroelectric facilities on the river was not reduced, nor was it reduced to a plant located on the Canadian side of the river. In order for plaintiff to meet its contractual obligations during the waterflow cutback it had to purchase alternative energy from another plant at increased costs. Plaintiff seeks the increased costs incurred in purchase of outside energy, claiming breach of contract arising from the reduction of waterflow to its plant for the 5-month period. It is *held* that the alleged acts of breach of contract were acts of an international organization, a sovereign body, and accordingly defendant is not liable for contract breach. Furthermore, the 1950 lease agreement granted defendant the right to act as it did in implementing the directive of the Commission. Plaintiff is not entitled to recover and the petition is dismissed.

Contracts; privity; Boundary Waters Treaty; International Joint Commission.

[1] Where a claim is based upon an act of a third party not in privity with the United States, there can be no recovery against the Government. For the United States to be liable for acts of a third party, the latter must, at the least, be an agency or instrumentality of the United States acting within the scope of its authority in entering into the disputed agreement and thereby binding defendant as a principal to it. Thus the fact that the United States is a member of the International Joint Commission organized to implement the Boundary Waters Treaty and participates in the Commission's actions, does not establish an agency relationship such as to make the United States liable to plaintiff in damages resulting from reduction of waterflow to plaintiff's plant, where the Commission is a sovereign body which may, at its option, act independently of the wishes of the United States.

United States ⚖59
Treaties ⚖8

Agency; agent of United States, what constitutes; Boundary Waters Treaty; International Joint Commission.

[2] The fact that the United States was the party which petitioned the International Joint Commission on boundary waters to issue the directive to reduce the waterflow to plaintiff's plant cannot be deemed

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to make the Commission an agent of the United States so long as the Commission was free, as a sovereign body, to reject the Government's suggestion.

Treaties ⚖8

Treaties; Boundary Waters Treaty; International Joint Commission and instrumentalities; directives and orders.

[3] The fact that the International Lake Superior Board of Control used the U.S. Army Corps of Engineers member of the Board as the vehicle for issuing the subject orders to plaintiff did not make the orders acts of the United States, since the orders were in compliance with the International Joint Commission and Board directives, and since the Board was required to have one member who was also an officer of the Corps of Engineers.

Treaties ⚖8

Treaties; Boundary Waters Treaty; International Joint Commission; jurisdiction of Commission.

[4] Although plaintiff's plant was built by its predecessor before creation of the International Joint Commission implementing the 1909 Boundary Waters Treaty, the Commission has jurisdiction over plaintiff by reason of its jurisdiction over any "use" of boundary waters. The owners have continuously "used" the waters within the scope of art. III of the Treaty, and a new "use" was created when plaintiff entered into an agreement with the United States extending the term of the lease to 2000. Both IJC and plaintiff's predecessors have acted under assumption that the Commission had jurisdiction over the plaintiff.

Treaties ⚖8

Treaties; Boundary Waters Treaty; International Joint Commission; delegable acts and powers.

[5] The fact that waterflow through plaintiff's plant was reduced based upon a report of the United States Army Engineers, does not make the reduction an act of the United States, where the report merely provided a factual background which the Commission could utilize to make its own independent decision, and where, in view of the difficult choices facing the Commission, it cannot be said that the way the order was implemented was arbitrary or a gross abuse of the Board's discretion.

Treaties ⚖8

Treaties; Boundary Waters Treaty; International Joint Commission; rule-making authority of Commission.

[6] A necessary aspect of a Commission's power to make rules in exercise of its authority is the ability to suspend those rules in response to an emergency situation and in a reasonable manner. In that sense, the action of the International Joint Commission in temporarily suspending its regulation plan respecting boundary waters in response to a perceived emergency may be considered a "rule or regulation" within the meaning of Sec. 2 of the 1950 lease agreement, as well as within the purview of the Commission's Rules of Procedure, particularly where the broad language of Sec. 2 makes the lease's provisions

subject to any "rule or regulation established or *recommended* by the Commission."

Treaties ⊂⇒8

Robert D. Wallick, attorney of record, for plaintiff. *Robert C. Kline, Jr.*, and *Steptoe and Johnson*, of counsel.

John W. Showalter, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Senior Judge*, DAVIS and KASHIWA, *Judges*.

COWEN, *Senior Judge*, delivered the opinion of the court:

Plaintiff, the Edison Sault Electric Company, brings this breach of contract action to recover $296,954.38 in damages arising from the United States' reduction of waterflow to plaintiff's hydroelectric plant at Sault Ste. Marie, Michigan. We agree with the parties that the facts material to a resolution of the issues are not in dispute and that the case may be decided on the motions for summary judgment. For the reasons set forth below, we conclude that plaintiff is not entitled to recover and that defendant's cross-motion for summary judgment should be granted.

The Edison Sault Electric Company (hereafter Edison or Edison Sault) is a Michigan public utility in the business of purchasing, generating, transmitting, distributing and selling electric energy in the Eastern Upper Peninsula of Michigan. Much of Edison's power derives from a hydroelectric generating plant at the Sault Ste. Marie rapids on the St. Marys River, a point of passage for water emptying from Lake Superior into Lake Huron. Edison Sault purchased the facility in 1962 from the Carbide Power Company, which in turn had purchased it from the original owner and builder, the Michigan Northern Power Company.

Plaintiff's plant was constructed in 1902 and is served by a 2½ mile long canal which diverts water from the St. Marys River. The plant is ¼ mile long and has 78 horizontally mounted generators with a combined rated capacity of 41,300 kilowatts. Water requirements are approximately 30,500 cubic feet per second (c.f.s.). Since the

plant operates by diversion of United States boundary waters, it was necessary for the owners to obtain Governmental authority to divert the boundary waters for private purposes.

Although the United States alone granted authority to construct the facility on the River, the St. Marys River is in fact a boundary with Canada, the boundary line running through the middle of the River and through the middle of the Great Lakes in either direction from the River. Actions taken by the Government or private parties on either side of the boundary can, and often do have significant effects upon interests on the other side of the boundary. This situation resulted in a number of disputes, which both the United States and Canadian Governments sought to resolve by entering into the Boundary Waters Treaty of 1909.

Thus, 7 years after construction of the facility now owned by plaintiff, the Canadian and American Governments agreed to create an International Joint Commission (hereafter I.J.C. or Commission), composed of three members of each country, to pass over questions affecting the boundary waters of the two countries. Specifically, the Commission was to approve any

> * * * uses or obstructions or diversions, whether temporary or permanent, of boundary waters on either side of the [boundary] line, affecting the natural level or flow of boundary waters on the other side of the line * * *. [Boundary Waters Treaty, art. III, 36 Stat. 2448 (1909).]

The jurisdiction of the I.J.C. was to be coextensive with its purposes of water control.[1] Since the ratification of the Treaty in 1909, the Commission has exercised jurisdiction over the waters from which plaintiff derives its power.[2]

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[1] In addition to Article III's requirement of I.J.C. approval for construction of facilities affecting water level or flow, Article IV of the Treaty requires I.J.C. approval for "construction or maintenance * * * of * * * protective works or any dams * * * the effect of which is to raise the natural level of waters on the other side of the boundary * * *." Article VIII of the Treaty then grants the I.J.C. jurisdiction over "all cases involving the use or obstruction or diversion of the waters with respect to which under Articles III and IV of this Treaty the approval of this Commission is required * * *."

[2] For a history of the I.J.C.'s work, *see* 3 Whiteman, *Digest of International Law*, 826–871 (1964). Plaintiff does not dispute the Commission's jurisdiction over the boundary waters; plaintiff *does* dispute the I.J.C.'s jurisdiction over its hydroelectric

On March 3, 1909, the United States, in section 11 of the Rivers and Harbors Act of 1909, Pub. L. No. 317, ch. 264 §§ 11, 12, 35 Stat. 815, amended the Act of 1902[3] to provide for Governmental acquisition, by condemnation and purchase, of most of the property north of plaintiff's facility and of virtually all the water flowing past Sault Ste. Marie. Thereafter, the plant's owners could use the St. Marys River waters only by leasing them from the Government, and all leases had to be approved by the Commission. Consequently, in September 1911, the Michigan Northern Power Company (then known as the Michigan Lake Superior Power Co.) applied and began negotiations for a "lease of water for the development of power." As a condition for granting the lease, the parties agreed in negotiations that the company would build "compensating" works—essentially a short dam with movable gates—in the center of the River to insure "a reasonable control of the level of the lake" while guaranteeing the company an adequate supply of power.

On May 26, 1914, the Commission issued its order and opinion granting the power company's application for a lease and requiring construction of the compensating works. As a part of its order, the I.J.C. created an International Lake Superior Board of Control (hereafter Board) to oversee and regulate "[a]ll compensating works [t]heretofore built and all such works built under this order of approval and all power canals" involved in the diversion of the St. Marys River. The objective of the Board was "to maintain the level of Lake Superior as nearly as may be between levels 602.1 and 603.6 above said mean tide at New York." Additionally, the I.J.C. empowered the Board to "determine the amount of water available for power purposes," and to "cause the amount of water so used to be reduced whenever in its opinion such reductions are necessary * * * to prevent unduly low stages of water in Lake Superior." The Board was to be composed of one officer of the United States Army Corps of Engineers, "charged with the improvement of the Falls of the St.

plant constructed upon those waters. *See* discussion *infra*.

[3] Act of June 13, 1902, Pub. L. No. 154, ch. 1079, 32 Stat. 331, 361.

Marys River on the American side," and one officer appointed by Canada.

The Board has from its inception regulated the elevation of Lake Superior and the outflow of the St. Marys River. Although the Board has operated under a number of regulatory programs, its present regulatory system was established in 1955. The Rule Plan of 1955, as it is known, derives from a "rule curve" which determines outflow for each month as a function of the mean lake level for the preceding month. The waterflow settings are altered monthly from May 1 to December 1, but from December 2 to April 30 they are altered only when the Lake Superior mean levels fluctuate unusually.[4]

The regulation of the elevation and outflow of Lake Superior was therefore clearly in the hands of the I.J.C., and by its delegation, in the hands of the Board when, in 1950, the United States entered into a new agreement with plaintiff's predecessor "to lease any surplus water available to the United States in St. Marys River, Michigan, which is not required for the operation of facilities owned by the United States * * *." Under the terms of the lease, the Michigan Power Company took "its requirements of water up to a maximum rate of flow of 33,000 c.f.s." in exchange for payment of $100,000 annually. The lease also contained the following clause:

> SECTION 2—It is mutually understood and agreed that this lease is made subject to the riparian rights of the lessor and to the rights of any lessee or lessees under any lease or leases for water power already made by the lessor and to any rules and regulations established or recommended by any International Commission that have or shall become operative * * * and the leasee [sic] shall neither assert nor make any claim for damages as against the lessor by reason of any such diminution made for such cause.

On October 1, 1962, after purchasing the power company from Carbide Power, Edison Sault entered into a novation agreement with the United States, agreeing to assume all Carbide's rights and obligations under the lease, including

[4] Specifically, alterations are made when levels move from a defined normal/intermediate range to a defined maximum or minimum range, or in the reverse.

rights and obligations assumed by Carbide in three supplemental agreements. Hence plaintiff is now the lessee under the 1950 lease, contract DA–20–064–Eng88 (hereafter DA–88).

For the most part, Edison Sault continued as lessee without incident until 1972. On June 30, 1970, it executed an amendment to the DA–88 contract, extending the term of lease until June 30, 2000. In July and September of 1972, extremely heavy rains hit the Great Lakes region, at a level 30 percent in excess of the normal rainfall for the season. The rains came at a time when the water levels of Lakes Michigan and Huron were more than 2 feet above the long-term average.

On September 27, 1972, Michigan congressman John G. O'Hara, alarmed by the ominously high water levels on the lower Great Lakes, wrote the I.J.C. requesting that it immediately review and reconsider its Rule of Regulation to permit consideration of water levels of lower Lakes in fixing the appropriate level of Lake Superior. Congressman O'Hara noted that the water level of Lake Superior, in contrast to the levels of the lower Lakes, was only 5″ above long-term average and 2½″ above the level for the same time in the previous year.

The Chairman of the I.J.C., Christian Herter, replied that the question raised by the Congressman was precisely the subject of a "complex study," which was initiated in 1964 and would be completed within a year, and that any action would have to await the completion of the study.[5] On November 8, 1972, the I.J.C. denied Congressman O'Hara's request on the ground that it could not alleviate the situation on the lower Lakes without "magnifying damage" on Lake Superior.

Heavy floods hit the Great Lakes 6 days later. Damage was so extensive that much of the lakeshore property (including virtually all of Congressman O'Hara's district) was declared a disaster area and made eligible for Federal relief funds.

On November 28, 1972, the Conference of Great Lakes Congressmen met to consider the problems of water control

[5] The report was ultimately released in October 1973. *See* Plaintiff's Exhibit S.

on the Great Lakes. Three days later, the 34 Congressmen wrote to the President requesting the Executive Branch to take appropriate action to relieve the situation on the lower Lakes and to insure that similar situations would not recur. Among the actions proposed by the Congressmen was a bilateral governmental request to the I.J.C. to "impound" water on Lake Superior as a function of the water levels of the lower Lakes. The President responded favorably to the Congressmen's request and directed his representative to meet with them on the matter.

On January 26, 1973, the United States Department of State made an emergency application for relief to the I.J.C. The United States requested that the Commission amend its order of 1914 to authorize and direct the United States:

1. To reduce water releases for power generation through power canals or other facilities operated under the authority and jurisdiction of the United States in the St. Mary's River to the extent necessary or feasible, in the judgment of the United States, to relieve the critical high water conditions on the lower Great Lakes * * *.
2. To restrict or prevent such flows for such periods as the United States may deem necessary, in no event longer than six months, or until the I.J.C. shall direct that such flows be restored.

The United States requested that the I.J.C. suspend such of its rules as might be necessary to act upon the Government's emergency application.

The I.J.C. met in executive session to consider the request of the Department of State. There was a great deal of discussion among the Commission members and representatives as to what would be the most appropriate permissible action. J. L. McCallum, the legal advisor to the Canadian Section, stated that the intent of the 1914 orders and the Commission's authority under the 1909 Treaty were to protect people and property from injury caused by the works approved. He said he found nothing in the Treaty or the 1914 orders which would permit the Commission to amend the orders regarding regulations. Major General E. Graves, chairman of the United States Section, disagreed. He stated in substance that there was nothing in the 1914 orders that established flows for high

water conditions and therefore felt that the Commission, consistent with the orders, could alter the flows to accomplish the results requested by the United States.

The I.J.C. resolved its doubts in favor of immediate action. On January 30, 1973, it directed the International Lake Superior Board of Control to reduce Lake Superior outflows from 71,000 to 55,000 c.f.s. for a 3-month period from February 1 to April 30, 1973. The order stated that the reduction was to be achieved chiefly by reducing the flow for power generation on the United States side of Sault Ste. Marie. The Commission further instructed the Board to deviate from its current regulation plan for the duration of the 3 months and to release the minimum quantity of water consistent with other requirements. The Commission also resolved that during the 3-month period, it would be considering a new regulation plan, which would for the first time permit regulation of Lake Superior as a function of lower Lake levels.

At the time the reductions in flow were ordered, the water level in Lake Superior was within the range of the 1955 Rule Curve and within the levels specified by the I.J.C.'s Orders of Approval of 1914. The effect of the reductions was to raise the water level in Lake Superior to a higher level than had previously been considered desirable under the prevailing Rule Curve.

Plaintiff first experienced the effect of the Commission's order on February 2, 1973, when it received a telegram from Colonel Myron D. Snoke, an employee of the United States Army Corps of Engineers. The telegram was an order to plaintiff to reduce the water flowing through its hydroelectric plant to a monthly average flow of 17,800 c.f.s. The directive was effective February 1 and was to continue until further notice. On March 22, plaintiff received another telegram from Colonel Snoke directing it to reduce the flow to 15,000 c.f.s. for the remainder of March; the April flow was to be restricted to about 15,000 c.f.s.

On the authority of an I.J.C. directive, the Board, on April 30, 1973, ordered plaintiff to again reduce its water flow from May 1 through June 30, 1973, to an average monthly rate of 14,700 c.f.s. Then, on May 29, the

Department of the Army, "[b]ased on instructions from the International Joint Commission and the Lake Superior Board of Control" directed Edison to reduce its flow even further, to 14,000 c.f.s. for the month of June 1973.

On July 1, 1973, plaintiff was allowed to release 33,000 c.f.s. of water through its power canal, thus restoring a full flow to its hydroelectric plant.

During the period of February 1, 1973 through June 30, 1973, the rate of flow to the United States-owned hydroelectric facility on the St. Marys River was not reduced, nor was the flow to the hydroelectric facility of Great Lakes Power Company, Ltd., successor to Algoma Steel, located on the Canadian side of the St. Marys River, reduced. As a result of the reduction in the flow of water to its plant during the period stated, it was necessary for plaintiff, in order to meet its connected loads and contractual obligations, to purchase alternative energy from Consumers Power Company at increased costs which amounted to $296,954.38.

Just prior to issuance of its order returning the flow to normal levels, the I.J.C., in June 1973, released a "Special Interim Report on Regulation of Lake Superior Outflows to Provide Relief from High Water Levels on the Lower Great Lakes." In this report the Commission for the first time officially proposed a plan of regulation of Lake Superior which took into consideration the water levels of the lower Lakes. The Commission declared that the objective of regulating the outflow of Lake Superior should be to provide benefits throughout the Great Lakes system without undue detriment to Lake Superior. However, the Commission stated that it should be given authority which it did not have to accomplish that objective. In that connection, the I.J.C. report stated:

> * * * adoption of a regulation plan for Lake Superior which takes into account the levels of Lakes Michigan-Huron constitutes a departure from the objectives and criteria prescribed in the Commission's Orders of Approval of May 26 and 27, 1914. It is the Commission's considered opinion that it cannot adopt the new objective and criteria under the terms of these Orders of Approval, which are still in force. Moreover, in these Orders of Approval, the Commission did not retain jurisdiction to

amend the Orders so as to establish new regulation objectives and criteria.

The report further stated that the emergency action which reduced the outflow from Lake Superior between January 30, 1973 and June 30, 1973, had had a net beneficial effect and was consistent with the proposed regulation objectives. Therefore, the Commission concluded that, unless otherwise instructed by the Canadian and American Governments, it would continue on a temporary basis a course of action consistent with these regulation objectives.

At about the same time that the Joint Commission issued its Interim Report, plaintiff presented a breach of contract claim to the Secretary of the Army. Edison's claim, filed on June 11, 1973, was denied by the Secretary of the Army by letter dated July 25, 1974, and this suit followed.

It is Edison Sault's contention that the United States breached its contract DA–88 with plaintiff by reducing the water flow for the 5-month period from February 1 to June 30, 1973. Plaintiff maintains that the I.J.C. had no authority to order the reduction; that the reduction was an act of the United States, performed in its contractual capacity, and that the cutback was a direct violation of the terms of contract DA–88. Edison Sault supports its argument that the United States acted in its contractual capacity and not as a sovereign by the fact that only Edison Sault was forced to reduce its flow, while the other power facilities on the river remained unaffected.

I.

Plaintiff recognizes that all of its arguments in behalf of its breach-of-contract theory proceed on the assumption that the order to reduce the water flow was an act of the United States in its contractual capacity. Plaintiff seeks to establish that the reduction was such an act of the United States on the basis of the following facts and legal assertions. First, plaintiff points out that it was the United States Government which applied in the first instance for a reduction-of-flow order from the I.J.C.; the application was made because of damages to United States lower Lakes

interests, who were able to exert considerable political pressure upon Congress and the Executive Branch. Second, plaintiff notes that it was an employee of the United States, Colonel Snoke, who actually ordered the flow reductions. Third, plaintiff asserts that the order could only have been an action of the United States as a matter of law, because the I.J.C. lacked jurisdiction over plaintiff. Finally, plaintiff calls attention to the fact that the determination as to which plant would bear the effects of a flow cutback was made exclusively by the United States Army Corps of Engineers without consultation with the I.J.C.

We disagree with plaintiff's principal contention, because we find that the order to reduce water flow was not an act of defendant but was, instead, the result of directives issued by the Commission, for which the United States may not be held liable. It is well settled where a claim is based upon an act of a third party not in privity with the United States, there can be no recovery against the Government. *Josef Best* v. *United States*, 154 Ct. Cl. 827, 836, 292 F.2d 274 (1961); *Rose Marie Porter* v. *United States*, 204 Ct. Cl. 355, 496 F.2d 583 (1974), *cert. denied*, 420 U.S. 1004 (1975).

For the United States to be liable for acts of a third party, the third party must, at the least, be an "agency or instrumentality of the United States acting within the scope of its authority in entering into the disputed agreement and thereby binding defendant as a principal to it." *Rose Marie Porter* v. *United States*, *supra*, 204 Ct. Cl. at 360, 496 F.2d at 587. The mere fact that the United States participates in the actions of the third party—in this case through its membership in the I.J.C.—does not establish an agency relationship where the third party is a sovereign body which may, at its option, act independently of the wishes of the United States. For example, in *Josef Best* v. *United States*, *supra*, the defendant was not held liable for action taken by the independent Allied High Commission of Germany, even though the United States was a member of that Commission.

Similarly, the facts relied upon by plaintiff are insufficient to establish an agency relationship between the United States and the I.J.C. The fact that the United States

was the party which petitioned the I.J.C. to issue the directives cannot be deemed to make the I.J.C. an agent of defendant. The I.J.C. is a sovereign body which was free to reject the application of the United States if it had so decided. The situation is analogous to that before this court in *Anglo-American Trading Corp.* v. *United States*, 109 Ct. Cl. 859 (1948), where we held that the United States could not be held liable for a trade embargo imposed by New Zealand, even though New Zealand was "induced" to order the embargo by acts of the United States.[6] The rule announced in that case is that the Government does not become a principal to an action by suggesting that action to a third party, so long as the third party is free to reject the Government's suggestion.

Plaintiff's second argument is that the Government should be held liable because the orders to reduce water outflow were given by a United States employee, Colonel Snoke of the U.S. Army Corps of Engineers. This argument overlooks the fact that while Colonel Snoke was an employee of the U.S. Army, his superior, General Graves, was a member of the International Lake Superior Board of Control. The Commission's 1914 Order of Approval, which created the Board, specified that one member of the Board be an "officer of the Corps of Engineers." The fact that the Board used Colonel Snoke and other employees of the Corps of Engineers as vehicles for issuing the orders to plaintiff did not make the orders the act of the defendant, especially since the orders stated that the cutback was by order of the I.J.C. and the Board.

The record is clear that when Colonel Snoke and other employees of the Corps of Engineers ordered plaintiff to reduce the water outflow, they acted as representatives of the Board in implementing the order of the I.J.C. and not as employees of the defendant. The orders from the Board, transmitted through Colonel Snoke and others, were in compliance with the directives of the Commission. In its first directive of January 30, 1973, which ordered the cutback on Lake Superior outflows, the I.J.C. instructed

[6] To an extent, the *Anglo-American Trading Corp.* case differs from the present dispute in that the court there also held that a trade embargo was a sovereign act for which defendant could not be liable even if it were the principal.

the Board to take the action required to achieve the objective and stated that the "reduction will be achieved in large measure by reducing the flows for power generation on the United States side of the international boundary at Sault Ste. Marie." Manifestly, the I.J.C. had to act through the Board, and General Graves, the United States member of that Board, was the superior of Colonel Snoke. Moreover, the reduction orders specifically stated that they were issued in accordance with I.J.C. directives. The very first telegram sent to plaintiff on February 1, 1973, stated that it was issued "to implement an order dated 30 January 1973 of the International Joint Commission to the International Lake Superior Board of Control." Similar language appeared in subsequent reduction orders, including the letter sent to plaintiff on May 29, 1973. Plaintiff was therefore expressly informed that the reduction orders were issued on the basis of instructions which the Corps of Engineers received from the Commission and the Board.

It is a reasonable inference from the documentary evidence before us that the Commission was kept informed regarding the reduction in water releases for power generation on the United States side, including plaintiff's plant in the St. Marys River, and that the Commission ratified the action that had been taken through its Board with knowledge thereof. On April 13, 1973, William A. Bullard, member of the United States Section and Secretary of the I.J.C. wrote to General Graves, the United States member of the Board, stating that the Commission had reviewed the Interim Report of the Great Lakes Level Board dated March 15, 1973 and had concluded that the period during which the outflow of Lake Superior would be reduced should be extended to June 30, 1973. The letter referred to the I.J.C.'s understanding that the reduction would be achieved "in large part by reducing water releases through the power generation facilities in the United States." Again on June 29, 1973, Mr. Bullard wrote General Graves, sending him a copy of the Commission's "Special Interim Report on Regulation of Lake Superior Outflows to Provide Relief From High Water Levels on the Lower Great Lakes." That report was dated June 28, 1973. The letter stated that the emergency action taken by the

Commission to reduce the outflow from Lake Superior had had a net beneficial effect and that it was the intention of the Commission to continue the same course of action on a temporary basis.

Persisting in its argument that the reductions were ordered by the defendant rather than by the I.J.C., plaintiff asserts that this had to be so because of the I.J.C.'s lack of jurisdiction over Edison Sault. This lack of jurisdiction is inferred from: (a) plaintiff's interpretation that Article VIII of the 1909 Boundary Waters Treaty required that only *new* diversions of water be approved by I.J.C. and therefore gave it no control over plaintiff's facilities which were already in existence before the Treaty was made; and (b) that in the I.J.C.'s Opinion of May 26, 1914, on the application of plaintiff's predecessor, the Michigan Northern Power Company, it was stated that plaintiff's works were "wholly within" the jurisdiction of the United States. We find both of these contentions are without merit.

It is true that Article VIII of the Treaty limits the jurisdiction of the Commission to cases involving the use, obstruction or diversion of waters covered by Article III. Article III states:

> * * * in addition to the uses, obstructions, and diversions heretofore permitted or hereafter provided for by special agreement between the Parties hereto, no further or other uses or obstructions or diversions, whether temporary or permanent, of boundary waters on either side of the line * * * shall be made except * * * with the approval, as hereinafter provided, of a joint commission, to be known as the International Joint Commission.

Plaintiff overlooks the word "uses" in the Treaty. Although plaintiff's plant was built before the creation of the Commission, plaintiff's "use" of the St. Marys River waters has continued incessantly since that time. Moreover, when on June 30, 1970, plaintiff entered into an agreement with the United States which extended the term of the lease from 1980 to the year 2000, a new "use" was thereby created. The very fact that plaintiff's predecessor, the Michigan Northern Power Company, filed an application with the Commission on June 30, 1913 for approval of the obstruction, diversion and use of waters of the St. Marys

River on the United States side of the boundary, was itself a recognition of the jurisdiction of the Commission concerning the power company's use of boundary waters.

Plaintiff's assertion that the Commission in its Opinion of May 26, 1914, ruled that it lacked jurisdiction over the hydroelectric plant is, we think, based upon an erroneous interpretation of the 1914 Orders of Approval. The Commission did not rule that it lacked jurisdiction over plaintiff's hydroelectric facility. Rather, it noted that:

> * * * the *position of the Government of the United States* is that the works of the applicant, being *located* wholly within its jurisdiction, it should be given full and final authority and control over their operation; * * *. [Emphasis added.]

Not only did the Commission use the term "jurisdiction" in describing the *position of the United States*, it also used the word to mean something other than the legal authority of the Commission. The word "located" indicates that the I.J.C. meant to characterize plaintiff's plant as being wholly within United States *boundaries*.

Moreover, the Commission in its Opinion went on to point out that:

> * * * the power of the commission, as a condition of its order, to place the control of these works, and the authority for the exercise of that control, exclusively under the Government of the United States, or under the joint control of both Governments is not disputed. * * *

As is evident, the Joint Commission would not have asserted its "power * * * to place the control of these works * * * under the joint control of both Governments" if it did not first assume that it had *a priori* jurisdiction over plaintiff's facility. Thus it is clear that the Commission's order, rather than declining jurisdiction over the hydroelectric plant, actually *asserted* authority over it.

Plaintiff makes a final contention in support of its position that the reduction was an act of the United States. This is so, plaintiff says, because the cutback was based solely on the report of the United States Army Engineers, and as a result of the report, only plaintiff's facility was adversely affected by the I.J.C. order, while other United States facilities were left untouched.

The record shows that when the defendant contemplated the filing of an application with the I.J.C. for a cutback in the outflow from Lake Superior, it requested the Corps of Engineers to make a report on the impact of closing down the Government-owned hydroelectric power facility at Sault Ste. Marie. On January 17, 1973, the Corps of Engineers reported that while Edison Sault could find alternative power sources, the power deficiencies that would result from the shutdown of the Government-owned plant could not be compensated from other areas. The report also stated that the largest consumer of the energy provided by the Government-owned plant was the Kincheloe Air Force Base, a fully operational SAC base, and that any reduction in the energy supplied to that base would have "serious defense implications."

The fact that the reduction orders were based upon that report does not make the reductions an act of the United States. The directive issued by the I.J.C. vested discretion in the Board as to the manner in which the directive should be executed. The report provided a factual background—a rational basis—for deciding among difficult choices. Under all circumstances, we cannot say that the way in which the I.J.C. order was implemented was arbitrary or a gross abuse of the discretion reposed in the Board. Therefore, the act did not give rise to liability on the part of the United States. *See, Restatement (Second) of Agency*, §§ 7(c), 17, 345 (1958).

At this point it should be noted that the International Joint Commission is an international organization which has been granted immunity from suit by the laws of the United States, except where it has expressly waived such immunity, 22 U.S.C. § 288 (1970). There is no evidence or any claim by plaintiff of any waiver of immunity by I.J.C. Since we have held that the actions complained of by plaintiff were the acts of such an international organization, it follows that plaintiff may not recover for the damages occasioned by such actions.

II.

Although we hold that the defendant is not liable for breach of contract, because the alleged acts of breach were

acts of the Commission, we would find no breach here even if the acts had been committed by the United States. We interpret the contract of lease, DA–88, to grant defendant the right to act as it did in implementing the directive of the Commission. The relevant contract provision is section 2 of the 1950 lease agreement, which makes the rights of the lessee (now plaintiff) subject to:

> * * * any rules and regulations established or recommended by any International Commission that have or shall become operative, * * *.

Plaintiff contends that this section does not permit defendant to avoid liability, because the I.J.C.'s action was not a "rule or regulation" within the meaning of the contract. This is true, plaintiff says, because the action of the Commission exceeded the guidelines of the Rule Curve or regulation plan then in effect, and the Commission admitted as much in its Interim Report of June 1, 1973, which stated that in the 1914 Orders of Approval "the Commission did not retain jurisdiction to amend the Orders so as to establish new regulations objectives and criteria."

However, plaintiff's argument misses the point of the contractual provision in question. The issue is not whether the I.J.C. retained jurisdiction to adopt a *new* regulation plan under the 1914 Orders, nor is the issue whether the Commission could *amend* the Orders to establish a new rule plan. The Commission conceded that it could not take either course of action. Rather, the question before us is whether the Commission's action in *temporarily suspending* its regulation plan in response to a perceived *emergency*, may be considered a "rule or regulation" within the meaning of the lease contract. We think that it may be so considered.

The State Department's application for I.J.C. action in this case requested the Commission to "suspend such of its Rules as may be required for immediate consideration of the Application, pursuant to Rule 9 of the I.J.C. Rules of Procedure." Rule 9 of the Commission's Rules of Procedure, of which we may take notice, reads as follows:

> 9. The Commission may suspend, repeal, or amend all or any of the Rules of Procedure at any time, with the concurrence of at least four commissioners. Both Governments shall be informed forthwith of any such action.

Even more broad than Rule 9, is Rule 10:

> 10. The Commission may, at any time, adopt any procedure which it deems expedient and necessary to carry out the true intent and meaning of the Treaty.

We think these rules reserved in the Commission sufficient authority to consider and act upon the United States' application for emergency relief in this case. It would be unreasonable to hold that the Commission, by its 1914 Order of Approval, tied its own hands so as to prohibit any temporary action outside its Rule Curve regardless of the gravity of the emergency. A necessary aspect of a Commission's power to make rules in exercise of its authority is the ability to suspend those rules in response to an emergency situation and in a reasonable manner. *United States* v. *O'Brien*, 391 U.S. 367, 380 (1968). In that sense, the proper suspension of a rule is as much a "rule or regulation" as the promulgation itself. *See also*, K. Davis, *Administrative Law Text*, §§ 6.01, 6.04, 6.10 (1972).

Additionally, it is important to note the extreme breadth of the clause in the 1950 lease, which makes the lease's provisions subject to any rule or regulation "established or *recommended*" by the Commission. On January 15, 1973, the I.J.C. informed the Lake Superior Board that the Commission was "considering, as a matter or urgency, the possibility of operating the control works at Sault Ste. Marie in such a way as to provide relief for the lower Great Lakes * * *." The Board was requested to report its "interim findings and conclusions with respect to possible modified operation * * *." The Board submitted an Interim Report on March 15, 1973, held hearings in May, and issued another report in June 1973.

As previously stated, in its June 1973 report the Commission acknowledged that it lacked authority to amend the 1914 Orders to establish new regulation objectives and criteria. But in the same report, the Commission stated that the emergency action which had been taken was beneficial and that it proposed to continue

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the same program on a temporary basis, if there were no objections by the governments of Canada and the United States. These proceedings show that the Commission was considering a new Rule and Regulation at the time of the outflow cutback and the record shows that it did in fact make a recommendation for a rule change in October 1974. It is therefore reasonable to conclude that the Commission's emergency action in 1973 was in accord with the new rule eventually proposed and was taken pursuant to "a rule or regulation * * * recommended by any International Commission * * *."

III.

Since we have concluded that plaintiff is not entitled to recover for the reasons stated above, we need not consider the Government's defense that plaintiff's claim is barred by the doctrine of sovereign immunity. Accordingly, plaintiff's motion for summary judgment is denied; defendant's motion for summary judgment is granted, and plaintiff's petition is dismissed.

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551 F.2d 843

THE PEOPLE OF THE STATE OF CALIFORNIA, ACTING BY AND THROUGH THE DEPARTMENT OF TRANSPORTATION v. THE UNITED STATES

[No. 281-75. Decided March 23, 1977]*

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Federal-Aid Highways Act; basis for compensation of acquired property.—The California Department of Transportation asserts a claim founded upon an express contract entered into in August 1967 with the United States Department of Transportation under the Federal-Aid Highways Act, for additional costs incurred by the State in acquiring for an interstate highway a right-of-way, which included the "McKinley School" property involved in the present proceeding. In November 1964 the United States authorized the State to proceed with

* On June 22, 1977 plaintiff filed a petition for a writ of certiorari.

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negotiations for and purchase of rights-of-way. In June 1965 the State entered into an agreement for acquisition from the Santa Clara school district of said property, i.e. the land and the school building thereon, and for construction of a replacement school. The August 1967 agreement between plaintiff and the United States confirms the rights-of-way authorization and obligates federal funds for the project subject to statutory and regulatory formula. Applicable regulations in effect in 1967 indicate that fair market value is the basis for compensation for real property taken for the highway. Plaintiff paid the school district an amount representing the replacement cost of the building. Since the sum was based on more than the market value of the old building, the United States refused to reimburse any amount greater than the amount it was contractually obligated to pay. Plaintiff seeks the difference between the cost of the building replacement and the fair market value defendant paid plaintiff. It is *held* that pursuant to the contract between plaintiff and the United States and the regulations in effect at the time the State became legally obligated to pay the right-of-way costs for the school property, plaintiff has been paid in full. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted and the petition is dismissed.

Federal-Aid Highways Act; construction and operation; basis for compensation of acquired property.

[1] Since the Federal-Aid Highways Act authorized the Secretary to make available to states funds for acquisition of rights-of-way in anticipation of construction under such rules and regulations as he may prescribe, enabling Regulations and the Policy and Procedure Memorandum effective in 1967 prescribing the amount payable to the states based on fair market value, consonant with the basis involving a private owner, was within the scope of the statute.

Highways ⚖99¼

Federal-Aid Highways Act; Policy and Procedure Memorandum; notice.

[2] Where the record shows that plaintiff complied with provisions of the subject Policy and Procedure Memorandum when it acquired the right-of-way, it is bound by its terms regardless of whether the Memorandum was published as a regulation in the Federal Register.

Highways ⚖99¼

Contracts; interpretation; enforcement according to mutually agreed-upon terms.

[3] Having entered into an express contractual agreement with the United States which provided the rules under which compensation was to be computed and paid to property owners whose property was taken for the highway, the State cannot now disavow that express agreement; the mutually agreed-upon terms of the contract govern and this court must enforce the contract according to its terms.

Highways ⚖99¼

Federal-Aid Highways Act; Policy and Procedure Memorandum; construction and operation.

[4] The term "lands" as used in Policy and Procedure Memorandum 21–4.1, para. 6.u, means all real property, including improvements on the land.

Highways ⊂⇒99¼

Federal-Aid Highways Act; construction and operation; generally.

[5] Since plaintiff's claim for additional costs which it incurred in acquiring a right-of-way for an interstate highway is based solely upon an express contract with the United States under the Federal-Aid Highways Act, the Fifth Amendment is inapplicable.

Highways ⊂⇒99¼

Federal-Aid Highways Act; highway funds, right to.

[6] In order to qualify for and receive federal funds under the Federal-Aid Highways Act, the State must comply with applicable federal regulations; the Federal Government is not bound constitutionally or statutorily to grant federal highways funds to States not complying with federal guidelines.

Highways ⊂⇒99¼

Federal-Aid Highways Act; regulations, retroactivity of.

[7] Since plaintiff became legally obligated to pay right-of-way costs for the subject property on the date it executed the contract therefor, the amount payable by the United States to plaintiff pursuant to the subsequently executed Federal-Aid Project Agreement pursuant to the Federal-Aid Highways Act is governed by the regulations in effect on the date of acquisition of the right-of-way and not by new regulations which became effective after execution of the Project Agreement. The fact that completion of the project occurred after the effective date of the new regulations is immaterial.

Highways ⊂⇒99¼

Milton B. Kane, attorney of record, for plaintiff. *Gordon S. Baca*, of counsel.

Stephen G. Anderson, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Lawrence S. Smith*, of counsel.

Before DAVIS, KASHIWA and KUNZIG, *Judges*.

KASHIWA, *Judge*, delivered the opinion of the court:

Plaintiff, the State of California, Department of Transportation, in this case asserts a claim founded upon an express contract with the United States under the Federal-Aid Highways Act (23 U.S.C. § 101, *et seq.* (1970)). Founding its claim under 23 U.S.C. § 106(a) (1970), plaintiff contends

that it is entitled to the sum of $158,941.68, which represents the additional costs incurred by the State highway department in acquiring the right of way for an interstate highway. This sum represents the difference between replacement cost which the State paid for property and fair market value on which the Federal Highway Administration reimbursed the State. Since this case propounds no genuine issue as to any material fact, it is properly before the court on cross motions for summary judgment. For the reasons set forth below, we agree with the defendant that under the Federal-Aid Highways Act plaintiff has been fully paid. We, therefore, grant defendant's motion for summary judgment.

I.

The statutory and regulatory[1] scheme under which this case arises is as follows: The Federal-Aid Highways Act (also "Act")[2] provides for joint federal and state participation in the construction of certain highways, with the actual construction to be undertaken by the state "subject to the inspection and approval" of the Secretary of Transportation ("Secretary").[3] (§ 114; 49 U.S.C. § 1655(a)(1) (1970).) The Act prescribes the formula under which funds are apportioned among the several states for this purpose. (§ 104.) Highway projects must meet standards adopted by the Secretary under section 109, and states wishing to avail themselves of the benefits of federal assistance under the Act must submit their construction proposals to the Secretary for his approval. (§ 105.) The Secretary is authorized to make available to states funds for the acquisition of rights-of-way in anticipation of construction, under such rules and regulations as the Secretary may

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[1] In this opinion, we use the term "regulation" figuratively to refer to regulations published in the Federal Register and Code of Federal Regulations as well as to policy and procedure memoranda. *See* note 10, *infra*.

[2] Unless otherwise indicated, all section references are to the Federal-Aid Highways Act, 23 U.S.C. § 101, *et seq.* (1970).

[3] That Act was originally administered by the Department of Commerce. When the Department of Transportation was created in 1966, the functions, powers and duties of the Secretary of Commerce under the Act were transferred to the Secretary of Transportation.

prescribe. Construction must take place within seven years thereafter. (§ 108(a) (1970).) If a proposed construction program is given approval, detailed plans, specifications and estimates must be submitted to the Secretary for his further approval. (§ 106.) When the Secretary approves the detailed plans for a specific project, the Act deems such approval "a contractual obligation of the Federal Government for the payment of its proportional contribution thereto." (§ 106(a).) "As soon as practicable" thereafter, a "formal project agreement" for the construction and maintenance of the project must be entered into between the Secretary and the appropriate state highway agency. (§ 110.) After completion of the project in accordance with the plans and specifications and after approval of the final voucher by the Secretary, a state is entitled "to payment out of the appropriate sums apportioned to it of the unpaid balance of the Federal share payable on account of such project." (§ 121(b).) The Secretary is authorized to prescribe and promulgate rules and regulations for the carrying out of the provisions of the Act. (§ 315.)

As previously noted, section 108 of the Act provides for making available funds to the states for the acquisition of rights-of-way in advance of construction, subject to such rules and regulations as the Secretary may prescribe. Policy and Procedure Memorandum ("PPM") 21–4.1 was promulgated in December 1960, effective February 15, 1961.[4] The regulation is entitled "RIGHT-OF-WAY PROCEDURES (State Acquisitions Under Federal-aid Procedures)." The purpose of the memorandum is stated in paragraph 1:

> The purpose of this memorandum is to prescribe the policies and procedures relating to Federal participation in right-of-way and property damage costs for which reimbursement is requested by the State under Federal-aid procedures.

Paragraph 5 of this regulation sets forth in detail numerous requirements which must be met by the state in order to obtain federal payments for right-of-way

[4] The "regulations" involved herein are those issued by the Department of Commerce, Bureau of Public Roads, entitled Policy and Procedure Memorandum. *See* note 10, *infra*.

acquisitions. The standard of fair market value is referred to by the regulations as the basis for compensation for real property. For example, paragraph 5.j.(1) states, in part:

> (1) Determination of Fair Market Value by State Reviewing Appraiser: Within each State highway department, one or more individuals, hereinafter referred to as reviewing appraisers, are authorized to determine the fair market value of real property, which amount is to govern negotiations and settlements. * * *

Paragraph 4 of the regulation is captioned "STATE RIGHT-OF-WAY ORGANIZATION, POLICIES AND PROCEDURES." Paragraph 4.a requires that:

> a. The State shall transmit under the signature of the chief officer of the State highway department, in triplicate, to the division engineer information as to the regulations, procedures, and manner in which right-of-way matters are handled by the State. Such information shall include, but not be limited to the following statements:

There follows a listing of 35 items of information that the state is required to submit to the federal authorities. The information called for by item (14) of this listing is:

> (14) When the State, in acquiring right-of-way, both by purchase and condemnation, becomes legally obligated to pay right-of-way costs.

Paragraph 3 of the regulation is captioned: "GENERAL PROVISIONS." Paragraph 3.a.(1) provides:

> a. Under Federal law and regulations, participation of Federal funds is permitted in right-of-way and property damage costs incurred by the States for highway projects financed in whole or in part with Federal funds under the circumstances and to the extent set forth below:
>
> (1) When there has been approval of a program and the State has been authorized to proceed with the right-of-way phase of a programmed project and the State subsequent to such authorization legally obligates itself under State law to pay right-of-way costs. The dates set forth by the State under paragraph 4a(14) shall be used in determining eligibility of right-of-way costs unless different dates are determined by Public Roads and included in its acceptance of the State's procedures.

As noted, paragraph 5 of the regulation, *supra*, sets forth numerous requirements that must be met by the state in order to obtain federal payment for right-of-way acquisitions. Paragraph 5.c provides, in part:

> c. Either at the time of program approval or subsequently, Public Roads shall issue a letter of authorization to the State to proceed with (1) studies to determine the relative right-of-way costs and other factors pertinent to alternate construction locations including incidentals connected with the acquisition of rights-of-way on a selected construction location, or (2) to actually acquire rights-of-way on a selected construction location including incidentals connected therewith, or (3) for both. * * *

Paragraph 6 of PPM 21–4.1 is captioned "ELIGIBILITY" and sets forth numerous criteria to be met in order for the right-of-way costs to be eligible for federal payment. Paragraph 6.a states:

> a. The authorization by the division engineer to proceed with acquisition of rights-of-way shall constitute approval of the necessity for the right-of-way to be acquired and the general eligibility for Federal participation in the cost of right-of-way items. Such authorization shall be in accordance with paragraph 5c.

Paragraph 6.u of the same regulation specifies:

> u. The amounts required to be paid for lands in public ownership shall be justified in the same manner and to the same extent as though the acquisition involved a private owner.

Paragraph 6.u of PPM 21–4.1 was amended by paragraph 5.1 of PPM 80–1 which went into effect November 15, 1968. Paragraph 5.1 provides:

> Generally, the amounts required to be paid for lands or improvements in public ownership shall be justified in the same manner and to the same extent as though the acquisition involved a private owner. The exception to the foregoing general rule would occur where the State highway department can demonstrate and the Director of Public Roads concurs that the functional replacement of the facility is necessary to preserve and protect the public's interest. In such instances Federal funds may participate in the depreciated reproduction cost of the improvements exclusive of betterments and the reasonable cost of acquiring a substitute site.

II.

In the early 1960's, the California Division of Highways was developing plans for an interstate highway. The plans for the highway involved property known as the "McKinley School" in the Franklin-McKinley School District of Santa Clara County, California. In September 1963, the Division of Highways had an official appraisal made of the property. The appraisal report reflected the market value of the property as $763,549.25.[5]

Under Federal-aid procedures, relating to federal participation in right-of-way and property damage costs for which the State would be requesting reimbursement, the California Highway Transportation Agency, Department of Public Works, Division of Highways, submitted the information required under PPM 21–4.1. Pursuant to paragraph 4.a of this regulation, *supra*, a statement dated April 1964 was formally transmitted to the Division Engineer, Bureau of Public Roads, Department of Commerce, Sacramento, California, by letter dated May 14, 1964.

By letter to the State Highway Engineer, Sacramento, California, dated November 17, 1964, the Division Engineer, Bureau of Public Roads, United States Department of Commerce, authorized the State to proceed with negotiations for, and the purchase of, the right-of-way that included the school property involved in the instant proceeding.

On June 16, 1965, the California Division of Highways entered into an agreement with the Franklin-McKinley School District of Santa Clara County, California, and the California Department of General Services for the acquisition of the McKinley School property and for the construction of a replacement school. The United States was not a party to the agreement and was not involved in the negotiation.

On August 14, 1967, the Bureau of Public Roads, United States Department of Transportation, and the Division of Highways, Department of Public Works, State of Califor-

[5] The appraisal reported the market value of the property as $763,549.25, which is the sum of $120,514.50 for land and $643,034.75 for improvements that included structures, equipment, yard improvements and utilities.

nia, entered into a formal Federal-Aid Project Agreement. This agreement confirms the effective date of the rights-of-way authorization, namely, November 17, 1964, and obligates federal funds for the project in the amount of $19 million, the estimated total cost of the project being $22,400,000. The agreement is bilateral, being signed by both parties, and provides, in pertinent part, as follows:

> The State, through its Highway Department, having complied, or hereby agreeing to comply, with the terms and conditions set forth in (1) Title 23, U. S. Code, Highways, (2) the Regulations issued pursuant thereto by the Secretary of Commerce and, (3) the policies and procedures promulgated by the Federal Highway Administrator relative to the above designated project, and the Bureau of Public Roads having authorized certain work to proceed as evidenced by the date entered opposite the specific item of work, Federal funds are obligated for the project not to exceed the amount shown herein, the balance of the estimated total cost being an obligation of the State. Such obligation of Federal funds extends only to project costs incurred by the State after the Bureau of Public Roads authorization to proceed with the project involving such costs.

The Federal-Aid Highways Act provides a complicated formula for determining the federal share payable to a state for the highways built under its provisions; for highways of the category involved in this case in California, it can be stated, generally, that the share was about 92 percent. (See §§ 104(b)(5) and 120(c).) The state obtains payment of these funds by submitting requests for such payments in the form of vouchers, as prescribed by the Federal Highway Administrator. (25 Fed. Reg. 4162, May 11, 1960, § 1.31; 23 C.F.R. § 1.31.)

In due course, the date of which is not shown by plaintiff, the State Division of Highways requested payment of the federal share for the acquisition of the right-of-way involved herein. Although not expressly shown by plaintiff in its petition, brief or exhibits, the federal-share request by the State with respect to the McKinley School was apparently based on $922,490.43, presumably the total cost of replacing the school purchased for the right-of-way with

another at a different location.[6] The federal share paid was based on the fair market value of the property, $763,549.25.

The State's request for payment of the federal share, with respect to the McKinley School property, based on more than the market value of $763,549.25 was rejected by the Bureau of Public Roads. The Bureau relied on paragraph 6.u of PPM 21–4.1, *supra*, which was applicable at the time of the State's acquisition on June 11, 1965, of the school property. After unsuccessfuly exhausting its administrative remedies, on August 4, 1975, plaintiff filed its petition in this court, seeking judgment for $158,941.68, plus interest thereon from June 16, 1965; its claim, founded upon § 106(a), represents an amount equal to the difference between replacement cost which the State paid for the McKinley property and fair market value on which the Federal Highway Administration reimbursed the State.

III.

Plaintiff recognizes that its claim is founded upon an express contract with the United States. Section 106(a) provides that approval by the Secretary of the plans, specifications and estimates for a given highway project submitted by a state shall constitute a contractual obligation of the Federal Government for payment of its proportional share. In the instant case these steps were taken and a contract resulted. This contract is in the form of the "Federal-Aid Project Agreement," dated August 14, 1967. In this bilateral document, it is provided that plaintiff has complied, or thereby agrees to comply, with the terms and conditions set forth in Title 23, U. S. Code, Highways, the regulations issued pursuant thereto and "the policy and procedures promulgated by the Federal Highway Administrator" relative to the project. It, thus, became contractually bound, *inter alia*, by the provisions of the policy and procedure memoranda of the Government.

[6] Plaintiff's petition and its brief imply that the total cost of the new school was $922,490.43; it claims the sum of $158,941.68, which (except for an insignificant discrepancy of 50 cents) is the difference between $922,490.43 and the appraised value of the school property, $763,549.25. However, in neither its petition nor in its brief has plaintiff set forth any proof or documentation of the said total cost of the new school.

The "regulations" involved here, PPM 21–4.1, were issued December 30, 1960, effective February 15, 1961.[7] A review of the provisions of those regulations show clearly that the basis for determining the federal share payable to the State for the instant property acquired was fair market value of the property. Nevertheless, plaintiff argues that the clear intent of Congress is to participate in the "total" cost of the construction of the highways, "without unilateral administrative decision excluding any portion of the cost of construction by the State." Plaintiff submits that there is no statutory basis for PPM 21–4.1 and, in fact, that it is squarely in conflict with the statutes upon which it is based; also, to the extent that PPM 21–4.1 denies just compensation, it is in violation of the Fifth Amendment of the United States Constitution and in violation of Article I, Section 14 of the Constitution of California.[8] We do not agree with the plaintiff.

The statute authorizes the Secretary to make available to states funds for the acquisition of rights-of-way in anticipation of construction under such rules and regulations as he may prescribe. (§§ 108, 315.) Pursuant thereto, the Secretary prescribed regulations which were published in the Federal Register, which provided, *inter alia*, that federal-aid funds shall not participate in any cost which is not incurred in conformity with the policies and procedures prescribed by the Administrator.[9] As shown, the policies

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[7] See note 10, *infra*.

[8] Article I, Section 14 of the Constitution of the State of California provides:

Private property shall not be taken or damaged for public use without just compensation having first been made to, or paid into court for, the owner, and no right of way or lands to be used for reservoir purposes shall be appropriated to the use of any corporation, except a municipal corporation or a county or the State or metropolitan water district, municipal utility district, municipal water district, drainage, irrigation, levee, reclamation or water conservation district, or similar public corporation until full compensation therefor be first made in money or ascertained and paid into court for the owner, irrespective of any benefits from any improvement proposed by such corporation, which compensation shall be ascertained by a jury, unless a jury be waived, as in other civil cases in a court of record, as shall be prescribed by law; * * *.

Article I, Section 14 was changed to Article I, Section 19 effective November 5, 1974.

[9] The regulations were published in the Federal Register May 11, 1960, 25 Fed. Reg. 4162, *et seq.*, and in the Code of Federal Regulations, 23 C.F.R. §§ 1.9, 1.14 and 1.32.

Section 1.9 provides as follows:

Federal-aid funds shall not participate in any cost which is not incurred in

and procedures which were prescribed by the Administrator and in effect at the time involved herein provided that the amounts to be paid for property in public ownership were to be justified in the same manner and to the same extent as though the acquisition involved a private owner, who was to be paid, under the regulation, fair market value. (PPM 21–4.1, paragraph 6.u.) Thus, under the regulation, the concept of determining the compensation on the basis of fair market value applied to acquisitions of both private and public property. To so provide is clearly within the scope of the statute and the regulations; plaintiff points to nothing to the contrary that is of any validity. Plaintiff argues that the payment to the State must be based on the "total cost * * * without unilateral administrative decision excluding any portion" of the State's cost of construction. This is incorrect. The regulation excludes numerous types of other costs which are not eligible for federal participation (see, e.g., PPM 21–4.1, paragraphs 6.b, 6.c, 6.i, 6.k, 6.m, 6.t). Furthermore, in a very recent case, the United States Court of Appeals for the Ninth Circuit upheld the principle that the terms of the Federal Highway Administration's Policy and Procedure Memorandum govern the amount payable to the state concerning highway programs under the Act and that the State of California was limited to such an amount irrespective of the fact that it had expended more and sought recovery on the basis of the larger sum. The court specifically rejected the State's argument that it is entitled to recover on the basis of the "total cost" of the

conformity with applicable Federal and State law, the regulations in this part, and policies and procedures prescribed by the Administrator. Federal funds shall not be paid on account of any costs incurred prior to authorization by the Administrator to the State highway department to proceed with the project or part thereof involving such cost.

Section 1.14 provides as follows:

Project agreements, and modifications thereof, shall be in forms satisfactory to the Administrator, evidencing acceptance by the State highway department of conditions to payment of Federal funds, as prescribed by Federal laws and the regulations in this part, and the amount of Federal funds obligated.

Section 1.32 provides as follows:

The Administrator shall promulgate and require the observance of such policies and procedures, and may take such other action as he may deem necessary for carrying out the provisions and purposes of the Federal laws and the regulations in this part.

project, without regard to the regulations. *People of the State of California* v. *United States,* 547 F. 2d 1388 (1977).

We also recognize plaintiff was on notice that the payment to it for the school property would be governed by PPM 21–4.1, under which the federal share was to be based on fair market value of the property. The State had notice not only of the regulations published in the Federal Register, but also of PPM 21–4.1, as shown by its submission to the federal authorities of the information and data called for by paragraph 4.a of PPM 21–4.1. Having knowledge of PPM 21–4.1 at the time it acquired the school property, plaintiff is bound by its terms regardless of whether the policy and procedure memorandum had been published as a regulation.[10] *United States* v. *Aarons,* 310 F. 2d 341, 348 (2d Cir. 1962); *Kessler* v. *Federal Communications Commission,* 326 F. 2d 673, 690 (D.C. Cir. 1963). Furthermore, it is important to bear in mind that plaintiff, by a bilateral contract signed by representatives of defendant and of the State of California, agreed, *inter alia,* to comply with the terms and conditions set forth in the policies and procedures promulgated by the Federal Highway Administration. Having entered into an express contractual agreement with the Federal Government which provided the rules under which compensation was to be determined, it clearly is bound by that contract. This court has so held in a similar situation, *Eldorado Canyon Resort, Inc.* v. *United States,* 209 Ct. Cl. 759 (1976); *Bishop* v. *United States,* 164 Ct. Cl. 717, 723 (1964) (Fifth Amendment taking cases). *See also Commonwealth of Massachusetts* v. *Connor,* 248 F. Supp. 656, 659 (D. Mass.), *aff'd,* 366 F. 2d 778 (1st Cir. 1966). Having agreed to one basis of computing costs and determining the amount to be paid, the State cannot now disavow that express agreement. The terms of the contract govern and the claimant cannot recover on a different basis.

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[10] We recognize that the Department of Transportation had ruled that the Federal Highway Administration memoranda do not rise to the status of regulations, 23 C.F.R. § 1.32(a) (1973). However, this fact does not affect the result in the instant case since plaintiff had knowledge of the memorandum in issue at the time it acquired the McKinley property.

Nevertheless, plaintiff argues that the term "lands" as used in PPM 21–4.1, paragraph 6.u, *supra*, refers to lands only and not to improvements. Plaintiff reaches this conclusion by analyzing subsequently issued policy and procedure memoranda which use the phrase "lands or improvements." *(See, e.g.*, PPM 80–1, paragraph 5.1, *supra.)* We, however, have carefully examined the 24 subparagraphs in paragraph 6, PPM 21–4.1, and have determined that the term "lands" as used in subparagraph 6.u means all real property. The other subparts of paragraph 6 use the terms "lands" and "real property" interchangeably; when the word "improvements" is used, it is in connection with rights-of-way acquired as land or real property. Furthermore, paragraph 5.q of PPM 21–4.1 shows clearly that the regulation uses the word "lands" to include improvements thereon, for it provides, in pertinent part:

> When lands are acquired for right-of-way purposes, all private installations thereon, except utility facilities the retention of which is clearly justified, shall be cleared therefrom prior to acceptance of the completed construction project, * * *.

We find, therefore, that there is no merit to plaintiff's contention in this regard.

Plaintiff has been paid in accordance with regulations to which it contractually agreed to be bound; it has no valid claim for any additional sum. We must, however, address plaintiff's constitutional argument.

Plaintiff argues that the provision under which the State was paid, paragraph 6.u of the regulation, "is unconstitutional as applied." Plaintiff first contends that the provision is in violation of the Fifth Amendment of the Constitution. We, however, do not find the Fifth Amendment applicable; plaintiff's claim is based solely upon an express contract with the United States. Next, plaintiff submits that under the California State Constitution the Federal Highway Administration "has no authority to enforce a regulation which requires a citizen of the State of California to accept less than just compensation nor does it have authority to force the State of California to pay less than just compensation when property is acquired by eminent domain." We feel that these are not the issues.

The Federal Highway Administration is not enforcing a regulation that "requires a citizen of the State of California to accept less than just compensation." As previously stated, defendant had an express contract with California under which the standard applied for payment is made applicable by the terms of the agreement. The arrangement between the parties is purely contractual. Plaintiff recognizes this; its brief specifically states that its claim in this suit "is founded upon an express contract with the Federal Government under the Federal-Aid Highway Act, 23 U.S.C. Section 106(a)." Its motion for summary judgment also contains the identical statement. Since the relationship between the parties is contractual, and the claim is based on the express contract between the parties, the contract governs; under it, plaintiff has been paid in full and has no further claim against the defendant. Likewise, plaintiff's assertion that the Federal Highway Administration does not "have the authority to force the State of California to pay less than just compensation when property is acquired by eminent domain," is not an issue in the case. The Federal Highway Administration made an express contract with the California department of highways, whereby California, by virtue of its agreement with the defendant, agreed to accept the compensation prescribed by paragraph 6.u of PPM 21–4.1. The defendant's dealings were with the California highway department, not with an individual citizen of California. Obviously, there was no taking by the Federal Government from any landowner in California; the State of California had the only dealings with the individual landowners and it alone, not the Federal Government, is responsible for such dealings. In any event, plaintiff's argument is of no merit. In order to qualify for and receive federal funds under the Act, the State must comply with the applicable federal regulations; the Federal Government is not bound constitutionally or statutorily to grant federal highway funds to states not complying with the federal guidelines. *State of Nebraska, Department of Roads* v. *Tiemann*, 510 F. 2d 446, 448 (8th Cir. 1975); *Port Authority of Saint Paul* v.

United States, 193 Ct. Cl. 108, 117–118, 432 F. 2d 455, 460 (1970); and cases cited therein.[11]

Lastly, plaintiff argues that since the highway project was not completed prior to amendment of paragraph 6.u, PPM 21–4.1, by paragraph 5.1, PPM 80–1, then without retroactive waiver of the provisions of PPM 21–4.1, but by application of the regulation in effect at the time of payment, this court should allow California's claim. We find plaintiff's argument misleading. As previously demonstrated, PPM 21–4.1 was issued December, 1960, effective February 15, 1961. California became legally obligated to pay right-of-way costs for the McKinley School property on June 16, 1965, the date it executed the contract with the School District.[12] The amount payable to the California Division of Highways by the United States is governed by the regulations in effect on that date. On August 14, 1967, when California entered into the Federal-Aid Project Agreement with the United States, it knew that the amount it would receive from the United States would be on the basis of fair market value of the property. The new regulation, PPM 80–1, paragraph 5.1, did not become effective until November 15, 1968, over three years after California executed the contract with the School District for purchase of the McKinley property and more than one year after plaintiff entered into the Federal-Aid Project Agreement with the United States. Thus, plaintiff agreed

[11] Plaintiff has not shown that the replacement value standard for public structures is so universally accepted in the United States that it might possibly be invalid for the Federal Highway Administration to refuse to accept it. A survey by the Government suggests that this standard is far from being universally adopted, and, though plaintiff cavils at the survey, it concedes flatly, in a post-argument submission to the court, that "the State of California does not contend that its recognition of the 'replacement cost' or 'substitute facilities' was a majority view in 1967" [when the contract in issue was executed].

[12] In answer to paragraph 4.a.(14) of PPM 21–4.1, *supra*, requiring information as to when the State becomes legally obligated to pay right-of-way costs acquired by purchase, the State advised, in pertinent part, as follows:

> The State becomes legally obligated to pay right of way costs at the time the right of way contract is executed by the District Engineer on behalf of the State. The contract has previously been executed by the grantor and approved by Headquarters Right of Way Office. At the time the contract is executed by the District Engineer a letter transmitting the fully executed contract to the grantor is also prepared and the date of this letter is evidence of the date the State becomes legally obligated to pay.
>
> * * * * *

Syllabus

to pay the School District more than fair market value of the McKinley property based on its own volition and with knowledge that it would not be reimbursed by the United States for any sum greater than the amount payable on the basis of fair market value. As a result, there is no basis for applying the new regulation. The fact that the whole section of the highway being built was not completed until some time after the effective date of the new regulation is immaterial.

Pursuant to the contract between the parties and the regulations in effect at the time California became legally obligated to pay the right-of-way costs for the school property involved, plaintiff has been paid in full.[13]

CONCLUSION

For the foregoing reasons, we grant defendant's cross motion for summary judgment and deny plaintiff's motion for summary judgment. Plaintiff's petition is dismissed.

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551 F.2d 278

ESTATE OF A. DEVEREAU CHESTERTON v. THE UNITED STATES

[No. 56-75. Decided March 23, 1977]*

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; estate tax; taxable estate; deductions; time for valuating claim; alimony.—The estate of decedent seeks to recover an alleged overpayment of Federal estate tax plus statutory interest. Prior to decedent's death he and his wife entered into a property and support agreement in anticipation of a divorce. In addition to certain payments during his life, decedent promised his wife a bequest of alimony

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[13] As an affirmative defense, defendant raised the question of whether plaintiff's claim is barred by the six-year statute of limitations, 28 U.S.C. § 2501 (1970), in that plaintiff's petition filed August 4, 1975, asserts a claim for compensation which accrued on June 16, 1965, the date of plaintiff's agreement with the school district. However, in open court during oral argument, defendant abandoned this defense; as a result, we need not discuss it.

* On June 21, 1977 plaintiff filed a petition for a writ of certorari.

Syllabus

payments of $500 per month for as long as she lived and remained unmarried. The payments began upon decedent's death when the wife was 64 years old. She remarried after receiving 9 monthly payments so that her entire claim against the estate was fully satisfied for $4,500. Plaintiff seeks to deduct from the value of the gross estate an amount computed on the basis of the wife's remaining life expectancy on the date of decedent's death, namely $59,047.97. It is *held* that the estate tax deduction is limited to the amount plaintiff actually paid to satisfy the claim, taking into consideration events after decedent died. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted and the petition is dismissed.

Taxes; estate tax; taxable estate; deductions; time for valuating claim.

[1] For purposes of fixing the time for valuating a claim against an estate, Sec. 812 of the 1939 Code in referring to amounts "allowed" under state law and Sec. 2053 of the 1954 Code in referring to amounts "allowable" are not substantially different.

Internal Revenue ⚖1010

Taxes; estate tax; taxable estate; claims against estate.

[2] The estate tax statute makes the estate of a decedent a separate and distinct taxable entity. The estate is the taxpayer and the statute requires it to pay a tax upon the net value of the estate it receives as a transfer by death, after deducting the amount of *bona fide* debts and claims that are allowable by the laws of the jurisdiction under which the estate is administered, and which it is entitled to keep and distribute to the beneficiaries. *Schiffman* v. *United States*, 100 Ct. Cl. 248, 51 F. Supp. 728 (1943).

Internal Revenue ⚖869

Taxes; estate tax; taxable estate; deductions; time for valuating claim; alimony agreement.

[3] Where decedent entered into a separation agreement with his wife agreeing, in addition to making certain payments during his lifetime, that his estate would pay her a stated monthly amount as long as she lived and remained unmarried, and where upon decedent's death the estate met the payment obligations for 9 months until the wife remarried, for estate tax purposes the estate is entitled to deduct only the amount actually paid the wife until remarriage and not the actuarially-estimated value at the time of decedent's death. *Ithaca Trust Co.* v. *United States, distinguished,* in that while the opinion contains language broad enough to embrace other types of disbursements, its rule designed to apply to charitable gifts is not necessarily applicable to other estate tax deductions.

Internal Revenue ⚖1010

Chester M. Howe, attorney of record for plaintiff. *Maxwell D. Solet, Gaston Snow* and *Ely Bartlett,* of counsel.

Bruce W. Reynolds, with whom was *Acting Assistant Attorney General Myron C. Baum*, for defendant. *Theodore D. Peyser* and *Donald H. Olson*, of counsel.

Before SKELTON, NICHOLS and BENNETT, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

This suit for a refund of estate tax requires that we decide whether to fix the value of a widow's alimony claim against her former husband's estate, deductible under § 2053(a)(3) of the Internal Revenue Code of 1954, as of the time of decedent's death, or to reduce the value of the claim in light of subsequent events. The parties apprise us of decisions by other courts lending support to both sides of this question, for the controversy is not as novel elsewhere as it is here. We can take refuge in the eye of the storm no longer. We limit plaintiff's deduction to the amount it actually paid to satisfy the claim, taking into consideration events after decedent died and, accordingly, we hold for the Government.

This purely legal issue emerges from undisputed facts. A. Devereau Chesterton died on May 15, 1969, survived by his former wife, Marjorie. Decedent and Marjorie had agreed in October 1966 to a property and support settlement in anticipation of their divorce. In addition to certain payments during his life, decedent then promised Marjorie a bequest of alimony payments of $500 per month for as long as she lived and remained unmarried. Marjorie was 64 years old when Chesterton died and the $500 monthly payments began. In order to determine its taxable estate, plaintiff computed the present value of Marjorie's claim against it with reference to her remaining life expectancy on the date of Chesterton's death, and, presumably, the likelihood of her remarrying. The parties agree that the correct product of this computation is $59,047.97, which plaintiff seeks to deduct from the value of the gross estate. In fact, however, Marjorie remarried after receiving from the estate only nine monthly payments, so that her entire claim against the estate was fully satisfied for the sum of $4,500. In auditing the estate tax return, filed thereafter,

the Commissioner of Internal Revenue disallowed all but this portion of the § 2053(a)(3) deduction, and assessed the resultant tax deficiency, which plaintiff has paid and claims for a refund. Plaintiff urges us to decide that the deduction for Marjorie's claim against Chesterton's estate was its commuted value at the time of his death. Since we hold that the claim must be valued in light of her subsequent remarriage, however, the Government shall prevail.

Both parties recall that in *Commissioner* v. *Estate of Shively*, 276 F.2d 372 (2d Cir. 1960), the Second Circuit, also, resolved a similar situation in the Government's favor. There, too, the estate sought to deduct the commuted value of a divorced wife's alimony claim, determined actuarially as of the time of decedent's death, even though the former wife actually remarried before the estate filed its tax return. The court reasoned that the governing statute, the predecessor of our present § 2053, contemplated a deduction only for amounts that do not pass by "gift" upon death. This purpose would not be served, in the court's view, by permitting a deduction for claims against an estate that were obviously unenforceable when the estate tax return was filed, even though the claims had vitality when decedent had died. Thus, the court limited the deduction for claims against estates to the amount of the claim established on the date the estate tax return is filed. *Id.* at 375. Plaintiff now suggests that, because the wording of the present statute differs from that of its predecessor, the cases are distinguishable. Specifically, the prior statute referred to amounts "allowed" under state law, while our § 2053 speaks of amounts "allowable." We, however, think the statutes are not substantially different, at least not with respect to the issue of fixing the time for valuating claims. On that point, which is the central issue in this case, *Shively* is apposite.

Plaintiff's more forceful argument is to urge upon us the "general rule" announced in *Ithaca Trust Co.* v. *United States*, 279 U.S. 151 (1929), that "[t]he estate so far as may be is settled as of the date of the testator's death." *Id.* at 155. At issue there was the value, as a deduction from the gross estate, of a remainder in property bequeathed to

charity at the conclusion of a life estate. All parties realized that the amount of the charitable deduction would be the market value of the property diminished by the widow's interim interest, but the date of valuation was contested. Since the widow had actually died within 6 months of decedent's own death, the executor sought to deduct the value of the remainder as it was in fact received by the charity. The Government, on the other hand, limited the deduction to the value of the property less the value of the widow's remaining life expectancy when decedent died. The Court agreed. Plaintiff now argues that the Court's reasoning in *Ithaca Trust* that net estates are properly valued as of the taxable event, decedent's death, requires that we determine actuarially the value of Marjorie's claim against Chesterton's estate on the date he died, regardless of the sum that the estate paid in fact.

Shively and *Ithaca Trust* are not the only precedents on the question, but mere numbers of lower court decisions are not necessarily decisive. Insofar as the Second Circuit's opinion in *Shively* is arguably inconsistent with the Supreme Court's statement of general principle in *Ithaca Trust*, it brings to mind another Supreme Court opinion, *United States* v. *Mason*, 412 U.S. 391 (1973). Our court had held in that case, 198 Ct. Cl. 599, 461 F. 2d 1364 (1972), that the United States breached its fiduciary duty toward the Osage Indians for failing to challenge Oklahoma's inheritance tax assessment on Indian land. We believed that recent circuit court decisions had placed in doubt the vitality of the Supreme Court's prior decision in *West* v. *Oklahoma Tax Commission*, 334 U.S. 717 (1945), which was directly in point and upon which the fiduciary relied in paying the tax without objection. The Supreme Court reversed, holding that the United States had not breached its fiduciary duty by declining to anticipate that the precedent might be overruled. Enroute to this conclusion, the Court expressed its difficulty in comprehending how decisions by lower courts can ever undermine the authority of a Supreme Court decision. 412 U.S. at 396–97. A further difficulty with *Shively* is that the opinion does not contain any clearly stated reason why *Ithaca Trust* is not decisive though the latter case is cited in *Shively* and heavily relied

on in a dissent. We proceed cautiously today, therefore, lest we be unduly influenced by other courts to curtail impermissibly the authority of *Ithaca Trust.*

We are confident, however, that we will not transgress the *Mason* rule, even by reaching a different result from *Ithaca Trust,* because it is our considered judgment that the situation presented here and that before the Court in *Ithaca Trust* are different. *Ithaca Trust* involved the valuation of a remainder in property given to charity. The Court had the benefit in its inquiry of Treas. Reg. 37, Art. 53 (Rev. 1921), which declared that the amount of the charitable deduction based on a gift of a remainder "is the value, at the date of the decedent's death, of the remainder interest * * *." See also *United States* v. *Provident Trust Co.,* 291 U.S. 272, 281 (1934). Although the *Ithaca Trust* opinion contains language broad enough to embrace other types of disbursements, its rule, designed to apply to charitable gifts, is not necessarily applicable to other estate tax deductions. The contemporary regulation concerning deductible claims, for example, stated:

> * * * It must appear in every case either that payment of the item has been made, or that such payment is clearly contemplated. * * * Where the disbursement has not been made, the item may be entered for deduction where the amount is certain, and it appears satisfactorily that it will be paid. No deduction may be taken upon the basis of a vague or uncertain estimate. Where an uncertain or contingent liability, not allowed as a deduction, becomes fixed, and payment is made, the remedy is a claim for refund of the excess tax. [Treas. Reg. 37, Art. 38 (Rev. 1921).]

We should not presume that the Court would have fashioned the same rule for deductions under this regulation that it did for charitable deductions. Our research reveals no instance, moreover, in which the Supreme Court itself relied upon *Ithaca Trust,* except in connection with the estate tax deduction for charitable gifts. *E.g., United States* v. *Provident Trust Co., supra.*

Furthermore, the Court never hesitated to limit *Ithaca Trust* to testamentary gifts that the charitable donee was reasonably certain, judging from the time of decedent's death, to receive eventually. But where the Court was not

shown that such a future interest would ever actually pass to the charity, the Court declined to invoke *Ithaca Trust*, and disallowed any deduction. *E.g.*, *Humes* v. *United States*, 276 U.S. 487 (1928) (gift of property that would pass to charity upon 15-year-old life tenant's death without issue and before age 40 too speculative a basis for estate deduction); *Commissioner* v. *Estate of Sternberger*, 348 U.S. 187 (1955) (similarly, a charitable bequest contingent upon decedent's 27-year-old daughter's dying without descendants that survive her mother); *Merchant's National Bank of Boston* v. *Commissioner*, 320 U.S. 256 (1943) (trustee's discretion to invade corpus for life tenant's "happiness" renders too indefinite any valuation of what a charitable remainderman might actually receive); *Henslee* v. *Union Planters Bank*, 335 U.S. 595 (1949) (same result where trustee could reach corpus for life tenant's "pleasure, comfort and welfare"). On the whole, it appears that *Ithaca Trust* has not been treated as the origin of an expanding concept.

The Supreme Court has not had the occasion to decide whether to apply to claims against estates the same analysis that it has to charitable deductions, but several lower courts have reached that question. In *Jacobs* v. *Commissioner*, 34 F. 2d 233 (8th Cir. 1929), decedent's widow elected to receive the net income for life from $250,000 of decedent's estate in lieu of her rights, under an antenuptial agreement, to $75,000 outright. The estate, nevertheless, sought to deduct the $75,000 as a claim against it existing at the time decedent died. The court disallowed the deduction, reasoning that the statute contemplated deductions for claims that would actually be paid from the estate. Whereas the widow had never claimed any amount from the estate under the antenuptial agreement, so that the gross estate was never decreased on that account, the court concluded that no deduction from tax was warranted. *Id.* at 235. The court commented:

> In our opinion a claim without a claimant was not in the mind or purpose of Congress when the words "claims against the estate" were written into the revenue statutes. * * * It was, in our opinion, claims presented and allowed or otherwise determined as valid against the

> estate and actually paid or to be paid that Congress had in mind, when it provided for the deduction from the gross estate of "claims against the estate" in determining the value of the net estate for taxing purposes.

The court observed, in response to the executor's argument that *Ithaca Trust* compelled a different result, that *Ithaca Trust* dealt with gifts to charities under paragraph 3 of the statute, not paragraph 1 which authorizes deduction for claims. These claims, like funeral expenses and administration costs which arise only after death, were intended by Congress to be determined in the course of an orderly administration of an estate. *Id.* at 236. "* * * [The Supreme Court] has not said that the deductions authorized by paragraph (1) * * * must be determined solely by the facts and conditions existing on the day of the death, and we are confident that court will never say so in view of the provisions of paragraph (1)."

If the Eighth Circuit's prophecy has come to pass, as it appears to have, it may well be for the reason the court advanced, that deductible claims more closely resemble funeral and administration expenses, necessarily valued after death, than they do gifts to charities. See also *Empire Trust Co.* v. *Commissioner*, 94 F. 2d 307 (4th Cir. 1938), for a similar result based, more narrowly, on the fact also present in *Jacobs*, that the widow's claim was not deductible because it supplanted her nondeductible dower interest.

In *Commissioner* v. *State Street Trust*, 128 F. 2d 618 (1st Cir. 1942), the First Circuit followed *Jacobs* in limiting a deduction to the amount determinable in light of events occurring after decedent's death. The widow there had compromised her claim to alimony for an amount of cash and future payments whose commuted value was less than that of her original claim. The statute establishing a deduction for sums allowed as claims under local law would not permit, in the court's view, a deduction larger than the maximum amount the estate would ever have to pay. *Id.* at 622.

Our court realized that *Ithaca Trust's* approach was not universally applicable in *Schiffman* v. *United States*, 100 Ct. Cl. 248, 51 F. Supp. 728 (1943). Upon that decedent's

death, his estate became liable as one among several guarantors of certain corporate debts, then in default and likely to be foreclosed. The executors deducted from the gross estate the amount of the creditor's claim against the estate, on a theory similar to that advanced by plaintiffs today, and filed the estate return. After negotiations, however, the creditor and the other guarantors reached a refinancing agreement, which did not call for any payments from the estate. We denied the estate tax deduction. Although we did not refer to *Ithaca Trust*, we stated our views on the subject of the deductibility of claims in language that applies to the present case as well:

> * * * The measure of the estate tax is not simply the value of assets less liabilities of the decedent at the time of his death. That is only the starting point. What subsequently happens with reference to debts of and claims against the decedent may be important. The statute makes the Estate a separate and distinct taxable entity * * *. The Estate is the taxpayer and the statute requires it to pay a tax upon the net value of the estate which it receives as a transfer by death, after deducting the amount of *bona fide* debts and claims "as are allowed by the laws of the jurisdiction * * * under which the estate is being administered," and which it is entitled to keep and distribute to the beneficiaries * * *. [*Id.* at 257, 51 F. Supp. at 732.]

In *Schiffman*, we held that the amount of a claim against the estate that was paid by another, so that the sum would remain available to beneficiaries of the estate, could not be deducted. We think that this position is still correct, supported by the weight of the law as it has developed, and we adhere to it.

Thus, having supplied the reason that *Shively* does not state, we disagree with plaintiff's contention that *Shively* was wrongly decided. We can now respond to plaintiff's remaining arguments briefly. First plaintiff draws various distinctions between its own circumstances and those presented in the cases we have discussed. The result in *Jacobs*, according to plaintiff, rests on the fact that the estate contested the claim, rendering its liability contingent and not subject to definite valuation. So, too, plaintiff says, was the case in *Schiffman*, where the estate assumed

merely a secondary liability as guarantor of the debt of another. We can concede that there exist some distinctions in fact, but fail to see how these made a difference. The central question in each case was to settle upon the appropriate date for valuing claims, and the outcome in each was to extend the valuation date beyond the date of decedent's death, without discernible regard for the characteristics of the particular claims in controversy. Lastly, plaintiff finds support for its position in several Tax Court decisions, especially *Estate of Lester*, 57 T.C. 503 (1972). Whether this decision is in fact inconsistent with the foregoing is unnecessary to decide, because we believe that the Tax Court's present view is reflected in *Estate of Hagmann*, 60 T.C. 465 (1973), which follows *Jacobs* and *Shively* in disallowing a deduction for otherwise valid claims that were not filed against the estate within the 6-month period required under state probate law. Plaintiff laments that *Hagmann*, also, was in error for departing from *Ithaca Trust*. We are of the contrary opinion, that this case like the others cited reflects the current state of the law.

Accordingly, defendant's cross motion for summary judgment is granted, plaintiff's motion for summary judgment is denied, and its petition dismissed.

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551 F.2d 282

ALLEN AARON JACKSON v. THE UNITED STATES

[No. 259–76. Decided March 23, 1977. Plaintiff's motion for rehearing denied April 29, 1977]*

ON DEFENDANT'S MOTION TO DISMISS

Military pay; enlistment contract; authority of Government officer; personal injuries; tort claim.—Plaintiff seeks to recover damages for alleged breach of a 3-year enlistment contract, asserting that the recruiting officer agreed that plaintiff would be allowed to attend an automotive mechanical maintenance school and that he would not be assigned to dangerous combative-type military activities. He was assigned to a tank division and during required basic combat training a tank ran over him necessitating amputation of the lower half of his

* Supreme Court *vacated* and *remanded* November 14, 1977.

Syllabus

body. The enlistment documents signed by plaintiff imposed no obligation on the United States to refrain from having plaintiff participate in field training exercises, and in addition they included plaintiff's statement that no promises or representations were made to him other than those in the written documents. Since May 29, 1974 plaintiff has received total disability benefits. In the present state of the record, it is *concluded* that the recruiter did not make the alleged promises or, if he did, he had no authority to do so, and accordingly plaintiff has no claim for damages for breach of contract. It is also *held* that plaintiff's action sounds in tort over which this court lacks jurisdiction. Under 28 U.S.C. § 2401(b) a tort claim against the United States is barred if filed more than 2 years after such claim accrues, and since this time has expired, no purpose would be served by transferring the case to the appropriate district court. Defendant's motion to dismiss is granted and the petition is dismissed.

Military pay; enlistment contract; generally.

[1] The enlistment documents and the statutory law in effect when they were signed by the recruit for military service constitute the enlistment contract. 10 U.S.C. § 505 requires written instruments for an enlistment.

Armed Services ⚖18

Military pay; enlistment contract; authority of Government agent.

[2] Assuming, *arguendo*, that the recruiting officer made oral representations to plaintiff that he would not be assigned to dangerous or combat-type military duties, absent a showing that the officer had actual authority to make the promise, the enlistee cannot recover on the theory of breach of the enlistment contract when he was assigned to such duty. One who purports to contract with the United States assumes the risk that the official with whom he deals is clothed with the actual authority to enter the contract alleged.

United States ⚖60
Armed Services ⚖18

Claims against the United States; authority of Government agent; unauthorized act of agent.

[3] The United States is not bound by its agents acting beyond their authority and contrary to regulations.

United States ⚖59

Court of Claims jurisdiction; misrepresentation by Government officer.

[4] A claim based on breach of an alleged promise or misrepresentation by a recruiting officer that plaintiff would not be assigned to any combative-type military maneuvers is a claim sounding in tort over which this court lacks jurisdiction.

United States ⚖131

James M. Garlock, attorney of record for plaintiff. *Belli & Choulos* and *Melvin M. Belli*, of counsel.

LeRoy Southmayd, Jr., with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

Before SKELTON, KUNZIG and BENNETT, *Judges*.

SKELTON, *Judge*, delivered the opinion of the court:

The plaintiff enlisted in the United States Army on February 25, 1974, for a term of three years by signing written documents of enlistment, which are discussed below. He alleges that the recruiting officer agreed with him that plaintiff would be allowed to attend an automotive mechanical maintenance school of the 1st Inf. Div. (M) at Fort Riley, Kansas, and that plaintiff would not be assigned to any dangerous-combative-type military maneuvers or functions. He reported for duty at Fort Riley, Kansas, on May 11, 1974, and was assigned to a tank division. On May 20, 1974, he was required to engage in dangerous combatant type maneuvers with his tank unit and during the maneuvers one of the tanks ran over the plaintiff, causing him to have the lower half of his body, from the navel down, amputated. Plaintiff argues that because of the foregoing, the Army breached the enlistment contract, and he sues here to recover $5,000,000 for such breach. The plaintiff is totally disabled and has been receiving total disability benefits in Grade PV2 since May 29, 1974.

The case is before us on defendant's motion to dismiss the plaintiff's petition. The defendant says that although plaintiff has couched his suit in terms of a contract action, his claim sounds in tort over which this court has no jurisdiction. Also, the defendant alleges that the enlistment documents signed by the plaintiff, copies of which are attached to defendant's reply brief, nowhere contain any provision that the plaintiff would not be assigned to any dangerous-combative-type military maneuvers or functions, and that if any such agreement was made orally by the recruiting officer, it was done without authority and contradicts the written enlistment documents and was and is null and void.

The Department of the Army records disclose that on February 25, 1974, plaintiff began his active duty service at the Chicago Armed Forces Entrance and Examination Station (AFEES). While at the station, plaintiff executed (1) Department of Defense Form 4 (DD 4), Enlistment Contract-Armed Forces of the United States; (2) Department of the Army Form 3286 (DA 3286), Statements for Enlistment, Parts I through V; and (3) Department of the Army Form 3286–47–R, Statements for Enlistment, Part VI.

In executing DA Form 3286, plaintiff acknowledged in Part 1, General Statement of Understanding, that "All promises made to me are contained in Items 3 (Rate/Grade), 37 (Rate/Grade Appointed/Reappointed), 48 (Untitled Item) of the DD Form 4, my Enlistment Contract." In the DD 4 executed by plaintiff, Items 3, 37 and 48 state in sequential order: "PVIE–1," "NA," "ENL FOR SUE ENL OPT (TABLE 5–41) 1ST INF DIV, FT RILEY, KS AND MOS 63A10 MECH MAINT." There were no promises made in the documents pertaining to service with any dangerous-combative-type military maneuvers or functions of the U. S. Army.

Also, DA Form 3286 contained the following provision:

> f. My choice of initial enlistment option shown in Item 48 of my DD Form 4 does not constitute any guarantee that a substantial part of my enlistment will be served in this option, and the needs of the service may result in my transfer at any time (other than as may be provided by the specific option selected) to any other assignment within the continental United States or to an oversea command.

Part VI of DA Form 3286–47–R specified:

> b. Unless I have previously completed basic or basic combat training (BCT) and served in the Army or Marine Corps in the past 3 years, I must complete BCT prior to undergoing advanced individual training (AIT).
> c. Upon completion of BCT, I will undergo AIT in military occupational specialty MOS (OJT) 63A10 MECHANICAL MAINTENANCE (Enter the MOS for which enlisted)

In executing DA Form 3286–47–R, plaintiff acknowledged that no other promises, representations, or commitments had been made to him other than as to the

statements set forth in this document, by writing in the word "None," as shown as follows:

> 2. UNDERSTANDING: I have read and understand each of the statements above and the statements contained in other parts of DA Form 3286, signed by me, and understand that they are intended to constitute all promises whatsoever concerning my enlistment. Any other promise, representation, or commitment made to me in connection with my enlistment is written below in my own handwriting, or is hereby waived. (If none, write "None.")
>
> X None

It is clear from the above enlistment documents the plaintiff signed that:

(1) Before the plaintiff could take the mechanical maintenance course he had to complete basic combat training. It is apparent that plaintiff had not complied with this requirement, as he had only been at Ft. Riley nine days when he was injured and obviously was engaged in basic combat training at the time of his injury. The plaintiff agrees that this is true.

(2) The plaintiff could be placed in any assignment at any time according to the needs of the service.

(3) The plaintiff stated in his own handwriting that no promises had been made to him in connection with his enlistment other than those contained in the enlistment documents he had signed, which are discussed in detail above.

(4) No promise, representation, commitment, agreement, or contract was made between the Army and the plaintiff in the enlistment documents in connection with his enlistment that provided that he would not be assigned to any dangerous-combative-type military maneuvers or functions during his service in the Army. It is clear that the documents, *supra*, executed by plaintiff upon entering active duty service in the Army, imposed no obligation on the United States to refrain from having plaintiff participate in a field training exercise, nor was there any prohibition from utilizing plaintiff in field training exercises.

Notwithstanding plaintiff's positive statement in the enlistment documents that no promises or representations were made to him other than those in the written documents, he now claims that he was promised by the recruiting officer that he would not be assigned to dangerous or combat-type military duties. He does not state whether such promises were oral or written, but since they are not in the written enlistment papers, he evidently contends that the representations and promises were made orally by the recruiting officer. If this is true, such oral promises and representations, if they were made by the recruiting officer, are not binding on the government. In *Goldstein* v. *Clifford*, 290 F.Supp. 275 (D.N.J. 1968), it was held:

> The enlistment instrument and the statutory law in effect when it was signed constitute the enlistment contract. * * * [*Id.* at 279.]

See also United States ex rel. Norris v. *Norman*, 296 F. Supp. 1270 (N.D. Ill. 1969) and *Pfile* v. *Corcoran*, 287 F. Supp. 554 (D. Colo. 1968). In our opinion, 10 U.S.C. § 505 requires written instruments for an enlistment. Otherwise, there would be no way the government could determine which branch of the service was involved nor the term or conditions of the enlistment.

Even if the Army recruiter made the alleged oral promises to the plaintiff, which defendant denies, plaintiff cannot recover on his contract theory unless he shows that the recruiter had the actual authority to make the statements on which plaintiff says he relied. *Housing Corp. of America* v. *United States*, 199 Ct. Cl. 705, 468 F.2d 922 (1972); *Operational Manuals, Inc.* v. *United States*, 205 Ct. Cl. 854 (1974). One who purports to contract with the United States assumes the risk that the official with whom he deals is clothed with the actual authority to enter the contract alleged. *Federal Crop Ins. Corp.* v. *Merrill*, 332 U.S. 380, 384 (1947); *Haight* v. *United States*, 209 Ct. Cl. 698 (1976), *cert. denied*, 429 U.S. 841 (45 U.S.L.W. 3251 (October 4, 1976)). Moreover, the United States is not estopped to deny the authority of its agents. *California-Pacific Util. Co.* v. *United States*, 194 Ct. Cl. 703, 720 (1971);

Putnam Mills Corp. v. *United States*, 202 Ct. Cl. 1, 479 F.2d 1334 (1973). The plaintiff has not proven that the recruiter had actual authority to make the alleged oral promises or representations, if he did in fact make them. It is well settled that the United States is not bound by its agents acting beyond their authority and contrary to regulation. *Federal Crop. Ins. Corp.* v. *Merrill, supra; Porter* v. *United States*, 204 Ct. Cl. 355, 496 F.2d 583 (1974), *cert. denied*, 420 U.S. 1004 (1975); *Operational Manuals, Inc.* v. *United States, supra.* In the present state of the record, the court is required to conclude that the recruiter did not make the alleged promises and representations, or, if he did make them, he had no authority to do so. In either case, the plaintiff has no claim for damages for breach of contract.

After a thorough, careful, and comprehensive review of the facts in this case by the court in view of the shocking severity of the plaintiff's injuries, we conclude that although plaintiff attempts to cast his complaint in terms of breach of an enlistment contract, the action sounds in tort. This court, pursuant to 28 U.S.C. § 1491, has no original tort jurisdiction. *Martilla* v. *United States*, 118 Ct. Cl. 177 (1950); *Eastport Steamship Corp.* v. *United States*, 178 Ct. Cl. 599, 372 F.2d 1002 (1967); *Clark* v. *United States*, 198 Ct. Cl. 593, 461 F.2d 781, *cert. denied*, 409 U.S. 1028 (1972); *Bibbs* v. *United States*, 206 Ct. Cl. 896, *cert. denied*, 423 U.S. 985 (1975).

In *McCreery* v. *United States*, 161 Ct. Cl. 484, 487–88 (1963), this court stated:

> The claim here is based on misrepresentation by the defendant's officers which the plaintiff relied on to his detriment. The claim thus sounds in tort. *Restatement of Torts* (1938) § 532; Prosser *Torts* (1941 ed.) § 87. See also *United States* v. *Neustadt*, 366 U.S. 696, 706, fn. 16 (1961). Repeatedly it has been held that under the Tucker Act (28 U.S.C. § 1491), which defines the general trial jurisdiction of this court, this court lacks jurisdiction over a case sounding in tort regardless of how vicious or malicious the tort may be. * * * [Footnote omitted.]

The case of *Bibbs* v. *United States, supra,* is very much in point. In that case we held:

> * * * Upon consideration thereof and of plaintiffs' response and of defendant's reply and of plaintiffs' response thereto, the court concludes that the motion should be granted because the action though pleaded in a contract form is an action sounding in tort over which this court has no jurisdiction under 28 U.S.C. § 1491 (1970); *Martilla* v. *United States*, 118 Ct. Cl. 177 (1950); *Eastport Steamship Corp.* v. *United States*, 178 Ct. Cl. 599, 372 F.2d 1002 (1967); *Clark* v. *United States*, 198 Ct. Cl. 593, 461 F.2d 781, *cert. denied*, 409 U.S. 1028 (1972); and on the basis thereof,
>
> IT IS ORDERED that defendant's motion to dismiss is hereby granted and that plaintiffs' petition be and the same is hereby dismissed. [206 Ct. Cl. at 897.]

If plaintiff's claim is based on the act or omission of the recruiting officer, an employee of the government, it would be excluded from coverage under the Tort Claims Act, 28 U.S.C. § 2680(a); *Clark* v. *United States, supra.* Furthermore, under 28 U.S.C. § 2401(b), a tort claim against the United States is barred two years after such claim accrues. This time period has expired in the instant case. Accordingly, no purpose would be served by transferring the instant case, under 28 U.S.C. § 1506, to the appropriate district court which has tort claims jurisdiction for proceedings under the Federal Tort Claims Act. Even if the limitations question were not involved and the case could be transferred to an appropriate district court, the plaintiff would be confronted with the decision of the Supreme Court in *Feres* v. *United States*, 340 U.S. 135 (1950) involving an Army lieutenant who was killed in a fire in an Army barracks, in which the Court stated at 141:

> * * * We know of no American law which ever has permitted a soldier to recover for negligence, against either his superior officers or the Government he is serving. * * * [Footnote omitted.]

The court deeply sympathizes with the plaintiff for the severe injuries he received while serving our country in the United States Army. However, the court is without jurisdiction, authority, or power to grant him any relief. It may be that he could get help from Congress by way of a

Congressional Reference case, but that is for him to decide.[1]

We hold that plaintiff's case sounds in tort and not in contract, and that we have no jurisdiction of his case. See 28 U.S.C. § 1491 and cases cited above.

The defendant's motion to dismiss is granted and plaintiff's petition is dismissed.

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552 F.2d 337

DE-TOM ENTERPRISES, INC. v. THE UNITED STATES

[No. 379–73. Decided March 23, 1977]

ON THE PROOFS

Eminent domain; taking; denial of zoning change by local authorities.—Plaintiff, owner of property located adjacent to March Air Force Base, claims that the Air Force, by opposing plaintiff's application to the County Board of Supervisors, prevented it from obtaining a zoning change from residential-agricultural, 5-acre minimum, to residential, single-family dwellings. Plaintiff contends that the opposition amounted to coercion and constituted a Fifth Amendment taking by the Federal Government of an interest in its land without just compensation. It is the general policy of the Air Force to prevent encroachments of high-density residential developments on land situated adjacent major military airports by informing local zoning authorities of its views and by attempting to persuade such authorities to restrict use of the land. Plaintiff did not seek judicial review in the California state or federal courts of the denial of its application, but has acquiesced in that decision. For the reasons given it is *held* that the United States is not liable for a Fifth Amendment taking, and, assuming that the County's action was unlawful, this court does not have original jurisdiction in tort. Plaintiff is not entitled to recover and the petition is dismissed.

Eminent domain; taking; regulations as a taking.

[1] Where there is no physical invasion of or physical damage to a claimant's property by the United States or its authorized agents, the Government can be held responsible for a Fifth Amendment taking only when its own regulatory activity is so extensive or intrusive as to amount to a taking.

Eminent Domain ⚖2(1)

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[1] J. Glosser, *Congressional Reference Cases in the United States Court of Claims: A Historical and Current Perspective*, 25 AM. U. L. REV. 595 (1976).

Per Curiam

Eminent domain; taking; what constitutes.

[2] Where the action of the Air Force in opposing plaintiff's application to the local zoning authorities for a change in zoning of its property did not result in any diminution of plaintiff's right, title or interest in the property, there was no taking of property by the Federal Government within the purview of the Fifth Amendment.

Eminent Domain ⚖ 2(1)

Court of Claims jurisdiction; tort claim asserted in petition.

[3] It is not within the jurisdiction of this court to determine whether the action of the Air Force in opposing plaintiff's application to the local zoning authorities for a change in zoning of its property was wrongfully coercive of said authorities, inasmuch as wrongful coercion amounts to tortious conduct, and tort actions are expressly excluded from this court's jurisdiction by 28 U.S.C. § 1491.

United States ⚖ 131

Arthur D. Guy, Jr., attorney of record, for plaintiff.

Hubert M. Crean, with whom was *Assistant Attorney General Peter R. Taft*, for defendant.

Before DAVIS, KASHIWA, and KUNZIG, *Judges*.

PER CURIAM: This case comes before the court on plaintiff's exceptions to the recommended decision of Senior Trial Judge Mastin G. White, filed July 16, 1976, pursuant to Rule 134(h), having been submitted on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's recommended decision (as hereinafter set forth), it hereby affirms and adopts said decision, as supplemented by the following paragraphs of this *per curiam* opinion, as the basis for its judgment in this case.

In addition to the trial judge's discussion, the court points out that plaintiff never sought judicial review (in the California state or federal courts) of the denial by the Riverside County Board of Supervisors of plaintiff's application for a change of zoning from RA–5 to R–1. On the contrary, plaintiff has acquiesced in that decision. We must therefore assume for this case that (a) that action by the County Board conformed with California law relating to zoning regulations (including common law, statutes, and the state Constitution), as well as with the federal Constitution, and (b) the refusal to allow R–1 zoning

represented a proper zoning decision within the powers of Riverside County. It is also clear that that zoning action, leading at most to prevention of a rise in market value but not to a destruction of all substantial use, did not constitute a taking by the County under California law. *HFH, Ltd. v. Superior Court of Los Angeles County*, 125 Cal. Rptr. 365, 15 Cal. 3d 508, 542 P.2d 237 (1975), *cert. denied*, 425 U.S. 904 (1976).[1] Plaintiff is therefore in the untenable position of urging that, although there was neither a taking nor improper regulatory action by the County entity which refused plaintiff's zoning application, the United States is nevertheless liable for a taking simply because the Air Force influenced Riverside County to adopt that proper and lawful regulatory stance. Such an extraordinary result could not be correct.

Moreover, even if we assume that the County's action was unlawful or even that it amounted to a taking by the County, the United States could not be held liable in this court. If the contention is that the Air Force acted wrongfully in influencing the County Board of Supervisors, we are plainly without jurisdiction because, as the trial judge points out, we have no original jurisdiction in tort. *See, e.g., Anglo-American Trading Corp. v. United States*, 109 Ct. Cl. 859 (1948). If plaintiff's position is that the Air Force necessarily took plaintiff's property (in the constitutional sense) simply by persuading the County Board not to change the zoning of the property, we must reject such a

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[1] Plaintiff invokes *Eldridge v. City of Palo Alto*, 57 Cal. App.3d 613, 129 Cal. Reptr. 575 (1976, hearing denied July 15, 1976), as modifying the principle of *HFH, Ltd.*, and recognizing that zoning can in some circumstances rise to a taking. The zoning regulation in *Eldridge* was, however, much more drastic than that involved in the case at bar. The land, when acquired by those claimants, was zoned for single-family residential use on minimum one-acre sites; thereafter, a regulation was adopted which designated the area for "open space use," permitting no less than a ten-acre site per house, all such sites to be subject to "open-space" uses. The gist of those plaintiffs' complaints was that the "open-space" ordinances denied them any reasonable or beneficial use of their land. The California Court of Appeals refused to dismiss the demands for just compensation on their face, holding that many factual issues remained to be resolved—including whether the ten-acre homesites would be salable at all and the reasonableness of the concept that such homesites must without compensation remain "open space." The differences from the instant case are apparent, including the fact that here De-Tom Enterprises complains of a failure to rezone so as to lift the value of the land, not a change in zoning which decreased the pre-existing value.

claim on its merits. Where as here there is no physical invasion of or physical damage to a claimant's property by the United States or its authorized agents,[2] the Government can be held responsible for a Fifth Amendment taking only when its own regulatory activity is so extensive or intrusive as to amount to a taking under the general principle of *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922). *See, also, United States v. Central Eureka Mining Co.*, 357 U.S. 155, 168 (1958); *Goldblatt v. Hempstead*, 369 U.S. 590, 592 *ff.* (1962). The recent case of *Benenson v. United States*, 212 Ct. Cl. 375, 548 F. 2d 939 (1977) (involving the Willard Hotel in the District of Columbia), is an instance in which Congressional legislation put such substantial and burdensome restrictions on an owner's use of his property that a taking had to be implied. But it is quite different when neither Congress nor a federal agency puts any regulatory burden on the owner but the agency, as an interested landowner, does no more than convince a state or local agency to impose such a burden, in the same way as might any other neighboring property owner or citizen. Here the Air Force was a powerful adjoining landholder, but so could be a large private manufacturer or comparable enterprise, or an organized group of citizens intent on preserving the environment or the character of their locality. In none of these cases would the intervention of the neighbor to persuade a county entity against rezoning the claimant's land constitute an eminent domain taking by the neighbor—whatever else it might be. The United States is thought to have a deep pocket and it is tempting for owners to try to shift to it the costs which they cannot or do not wish to impose on the local entity which actually undertakes the zoning, but the fundamental point is that it is that agency (here the County Board) which adopts, and has the power to adopt, the allegedly injurious course, and the federal agency (here the Air Force) is only playing the role of an influential affected landowner trying to persuade the county body to accept its position.[3]

[2] Of course, every physical invasion or damage does not rise to the level of a taking. *See, e.g., Avery v. United States*, 165 Ct. Cl. 357, 330 F.2d 640 (1964).

[3] Compare the attempt, rejected in *D.R. Smalley & Sons, Inc. v. United States*, 178

For these reasons, and those given by the Trial Judge, we hold that the plaintiff is not entitled to recover and the petition is dismissed.

OPINION OF THE TRIAL JUDGE

WHITE, *Senior Trial Judge:* The plaintiff asserts a claim under the provision of the Fifth Amendment to the Constitution which declares, "nor shall private property be taken for public use, without just compensation." In asserting this claim, the plaintiff presents for consideration a novel theory concerning an alleged taking by the Government of an interest in land owned by the plaintiff.

The land involved in the present case is a 38.93-acre parcel situated in Riverside County, California. It lies to the east of, and adjacent to, March Air Force Base, which is the home base of the 22nd Bombardment Wing, a unit of the Fifteenth Air Force, Strategic Air Command. The 22nd Bombardment Wing is equipped with B–52 heavy bombers and KC–135 tanker planes. Both the B–52 and the KC–135 are multi-engine jet aircraft.

The plaintiff's property is located sufficiently close to portions of March Air Force Base where noise-producing activities are carried on—*e.g.*, the repair area (where dismounted jet engines are repaired and tested), the warm-up area (where the jet engines of operational aircraft are warmed up before the aircraft proceed to a runway for takeoff), and a north-south runway—that jet-engine noise emanating from March Air Force Base is audible much of the time to anyone on the plaintiff's property. However, the plaintiff does not complain in the present case of the impact of such noise on its property. Rather, the plaintiff contends that the noise is not unduly disturbing, and complains that the Air Force prevented it from obtaining a change of zoning that would have permitted the property to be developed for high-density residential purposes. The

Ct. Cl. 593, 372 F.2d 505, *cert. denied*, 389 U.S. 835 (1967), by a highway contractor to hold the United States liable, either as a contracting party or as a "taker," for highway construction undertaken by a state with a financial grant from the Federal Government. *See, also, Edison Sault Electric Co.* v. *United States*, *ante* at 321–22, 552 F. 2d 326, 333.

pertinent circumstances will be summarized in subsequent paragraphs of this opinion.

The 38.93 acres comprising the plaintiff's property (which will usually be referred to hereafter in the opinion as "the property") were acquired by the plaintiff in three separate transactions during the period which began in August 1963 and ended in February 1964. In acquiring the property, it was the plaintiff's intention ultimately to develop it for residential purposes by building low-cost homes on it. However, at the time of the acquisition of the property by the plaintiff, and for a few years thereafter, the property was subject to an M–3 zoning, which was imposed by the Riverside County Board of Supervisors and which restricted the use of the land to manufacturing or industrial purposes. In 1967—without any request for such action having been submitted by the plaintiff—the Board of Supervisors changed the zoning of the property from M–3 to RA–5, which permitted the property to be used for residential-agricultural purposes and to be subdivided into smaller parcels of not less than 5 acres each. The plaintiff did not take advantage of this change of zoning by subdividing the property into 5-acre parcels, as it was still the plaintiff's intention to develop the property for high-density residential purposes. The plaintiff did, however, devote the land to residential-agricultural use by leasing the property to an individual who lived on the property and operated on it a horse-training center and riding school.

In order for the plaintiff to carry out its intention of developing the property for high-density residential purposes, it was necessary for the plaintiff to obtain from the Riverside County Board of Supervisors a change of zoning for the property, from RA–5 (residential-agricultural, 5-acre minimum) to R–1 (residential, single-family dwellings). Accordingly, on or about July 28, 1971, the plaintiff submitted an application requesting that the zoning of the property be changed from RA–5 to R–1.

The plaintiff's application for a change of zoning was considered and approved by the Riverside County Planning Commission on September 8, 1971, and by the Riverside County Airports Land Use Commission on November 11,

1971. The application then went before the Riverside County Board of Supervisors for final action.

A hearing on the plaintiff's application for a change of zoning was held by the Riverside County Board of Supervisors on November 16, 1971. Only the Air Force appeared at the hearing in opposition to the application. The Air Force was represented by the Staff Judge Advocate of March Air Force Base, who reminded the members of the Board that the Government had invested more than $100,000,000 in March Air Force Base, and expended approximately $70,000,000 per year on operations at the base. The Staff Judge Advocate further stated that it was anticipated by the Air Force that if the area immediately adjacent to the base were to be developed for high-density residential use, complaints about the noise emanating from the base by individuals and groups of individuals living near the base might ultimately compel the Air Force to curtail, or perhaps discontinue, operations at the base; that the property involved in the application was subject to the highest intensity of noise emanating from the base; and that the "encroachment" of high-density residential development on the property would be incompatible with the continued use of March Air Force Base for military operations at the then-current level.

There was also submitted to the Riverside County Board of Supervisors at the hearing a letter from the Commander of March Air Force Base, expressing the view of the Air Force that, because of the impact on the property of jet-engine noise emanating from March Air Force Base, the property would be "highly undesirable for any type of residential use." The letter from the Base Commander further stated in part as follows:

> * * * [T]his property lies only a few hundred feet from the Base jet engine runup areas, and as such, is frequently subject to the most intense noise created on the base.
>
> We are, as you know, highly concerned with any residential encroachment to the Base which would increase citizens' complaints, which the noise problem may well be expected to generate. * * *

The actions of the Staff Judge Advocate and the Base Commander of March Air Force Base in opposing the plaintiff's application for a change of zoning were in accordance with the general policy of the Air Force to prevent, if possible, "encroachments" of high-density residential or commercial developments on lands situated in the immediate vicinity of major military airports. It was the view of the Air Force (as explained more fully in the findings of fact) that if lands located near a major military airport were to be developed for high-density residential or commercial use, individuals and groups of individuals living on or using the lands would be so affected by the noise emanating from the airport that they would register complaints of such volume and intensity as ultimately to compel the curtailment, or perhaps the discontinuance, of the military mission of the airport. The Air Force made a practice of informing local zoning authorities of its view concerning proper land use in the vicinity of military airports, and attempted to persuade such authorities to restrict the use of nearby lands to agricultural or industrial purposes, and not to permit such lands to be used for high-density residential or commercial development.

At the conclusion of the hearing on November 16, 1971, the Riverside County Board of Supervisors denied the plaintiff's application for a change of zoning from RA–5 to R–1.

The evidence in the record warrants the inference that if the Air Force had not opposed the plaintiff's application for a change of zoning. the application would have been approved by the Riverside County Board of Supervisors.

It is the plaintiff's theory of the case, as stated in the petition, that "The coercion exercised by the Department of the Air Force upon the Board of Supervisors * * * which has thus prevented reasonable use of The Property constitutes a taking of private property for public use without just compensation * * * [and] violates the Fifth Amendment to the Constitution of the United States."

Even if it is assumed, *arguendo*, that the action of the Air Force in opposing the plaintiff's application for a change of zoning constituted wrongful coercion of the Riverside County Board of Supervisors, such coercion did not result

in a taking by the Government from the plaintiff of any property right, title, or interest that the plaintiff had prior to the exercise of such coercion.

Immediately prior to the time when the Riverside County Board of Supervisors—yielding to the assumed coercion of the Air Force—denied the plaintiff's application for a change of zoning, the property was zoned for RA–5 use, which meant that the plaintiff could use the property for residential-agricultural purposes and could subdivide the 38.93-acre parcel into smaller parcels of not less than 5 acres each, if the plaintiff so desired. After the Board of Supervisors denied the plaintiff's application for a change of zoning, the property was still zoned for RA–5 use, so the plaintiff's right, title, and interest in the property were precisely the same as they had been prior to the action of the Board of Supervisors.

Also, the evidence in the record shows that the action of the Riverside County Board of Supervisors in denying the plaintiff's application for a change of zoning did not affect the fair market value of the property in any way. On November 15, 1971, the date preceding the action of the Board of Supervisors, the fair market value of the property, with its RA–5 zoning, was $82,700. On November 17, 1971, the day following the action of the Board of Supervisors, the fair market value of the property, with its RA–5 zoning, was still $82,700.

Therefore, inasmuch as the action of the Air Force in opposing the plaintiff's application for a change of zoning did not result in any diminution of the plaintiff's right, title, or interest in the property, it necessarily follows that there was no *taking* of property by the Government, within the scope of the Fifth Amendment to the Constitution.

The action of the Air Force did prevent the plaintiff from *acquiring* a valuable property right which had not been available to the plaintiff theretofore and which the plaintiff desired to secure, *i.e.*, the right to develop the property for high-density residential purposes. However, it is not within the jurisdiction of this court to determine whether the action of the Air Force was, as alleged by the plaintiff, wrongfully coercive of the Riverside County Board of Supervisors, inasmuch as wrongful coercion would

amount to tortious conduct, and tort actions are expressly excluded from the jurisdiction of this court by 28 U.S.C. § 1491.

For the reasons previously stated in this opinion, the plaintiff is not entitled to recover in the present action, and the petition should be dismissed.

FINDINGS OF FACT

1. (a) The plaintiff is, and at all times material to this litigation has been, the owner of 38.93 acres of land situated in Riverside County, California, and described as Lots 4 and 5, Block 2, Riverside Alfalfa Acres, as shown by map at page 21 in Book 8 of Maps, Riverside County Records. (This land will usually be referred to hereafter in the findings as "the property.")

(b) The property was acquired by the plaintiff in three separate transactions during the period which began in August 1963 and ended in February 1964.

(c) The two lots comprising the property are contiguous and, together, form a square-shaped parcel of land.

2. (a) The plaintiff acquired the property for the purpose of ultimate residential development, it being his intention to build low-cost homes on it. However, at the time of the acquisition of the property, and for a few years thereafter, the property was subject to an M–3 zoning, which was imposed by the Riverside County Board of Supervisors and which restricted the use of the land to manufacturing or industrial purposes.

(b) In 1967, the Riverside County Board of Supervisors changed the zoning of the property from M–3 to RA–5, which permitted the property to be used for residential-agricultural purposes and to be subdivided into smaller parcels of not less than 5 acres each. This change of zoning was made without any request therefor being submitted by the plaintiff.

3. In 1971—the time directly involved in the present litigation—the property was still subject to the RA–5 zoning mentioned in finding 2(b). The property was leased to an individual, who operated a horse-training center and riding school on the property. The permanent improvements on the property included a one-story single-family residence, a structure which was being used as a dormitory for riding-school students and which also provided office space and storage space, two barns, a hay shed, a storage

shed, and a number of horse stalls. The lessee lived on the property.

4. (a) The property is located east of, and directly adjacent to, March Air Force Base, a military facility operated by the Air Force. The property is separated from the base by a street known as Heacock Street, which is approximately 40 feet wide.

(b) March Air Force Base was in existence long before the property was acquired by the plaintiff.

5. March Air Force Base is the home base of the 22nd Bombardment Wing of the Fifteenth Air Force, Strategic Air Command, United States Air Force. This wing is equipped with B–52 heavy bombers and KC–135 tanker planes. The B–52 is an 8-engine jet bomber, and the KC–135 is also a multi-engine jet aircraft.

6. (a) The repair area on March Air Force Base, where dismounted jet engines are repaired and tested, is located about 1,200 feet to the west of the northern portion of the property, at the nearest point; the warm-up area on the base, where the jet engines of operational aircraft are warmed up before the aircraft proceed to a runway for takeoff, is located about 1,200 feet to the west of the central portion of the property, at the nearest point; and a north-south runway on the base is located some 1,500 feet to the west of, and parallel to, the western boundary of the property.

(b) The evidence in the record indicates that jet-engine noises emanating from March Air Force Base are audible much of the time to individuals on the property, but that the noise level generally does not interfere with the conduct of normal activities on the property. Sometimes, however, the noise level increases to the point where the noise does interfere with vocal communication on the property, but such instances are of short duration.

(c) There has not been any increase in the noise level on the property from aircraft operations at March Air Force Base during the period since the property was acquired by the plaintiff in 1963–64.

(d) The plaintiff does not assert any claim in the present litigation based upon the effect on the property of noise generated by aircraft operations at March Air Force Base.

7. Prior to purchasing the property, the plaintiff did not make any inquiries of local governmental or Air Force officials regarding the suitability of the property for residential development in the light of the impact of

aircraft operations at March Air Force Base upon the surrounding environs.

8. (a) As of October 1, 1964, the Department of the Air Force promulgated Air Force Manual No. 86–5, which was entitled "Land Use Planning With Respect to Aircraft Noise" and which prescribed a procedure for predicting the average community response to engine noise generated by aircraft operations. It was intended to be used as a guide in planning land use for areas located in the vicinityof airports.

(b) Under Air Force Manual No. 86–5, composite noise ratings were scientifically assigned to the various types of aircraft operations. Then, on the basis of such ratings, the response to be expected from individuals or groups residing or working within geographical zones having a relationship to the source of, and likely to be affected by, the noise was estimated. The scheme contemplated that three such geographical zones—designated as CNR Zone 3, CNR Zone 2, and CNR Zone 1—would be established within the environs of each major airport operated by the Air Force.

(c) CNR Zone 3 was to include the geographical area where the noise emanating from aircraft operations at an airport was expected to have the greatest impact, where it was to be anticipated that individual reactions to the noise would probably include repeated, vigorous complaints, and where concerted group action against the noise was also to be anticipated.

(d) CNR Zone 2 was to include the geographical area where the noise from aircraft operations at an airport was expected to have less impact than in CNR Zone 3 but where it was to be anticipated that some individuals would complain about the noise.

(e) CNR Zone 1 was to include the geographical area where, although the noise from aircraft operations at an airport might interfere occasionally with certain activities of the residents of the zone, it was to be anticipated that virtually no complaints about the noise would be received.

9. In connection with the establishment of CNR zones within the environs of its major airports, the Air Force developed what was known as a "greenbelt" concept for the protection of such airports from what the Air Force regarded as undesirable "encroachments" in the form of types of land use that might, unless prevented, ultimately interfere with the military mission of the airports by virtue of the number and intensity of complaints made by individuals and groups against the airport noise. In accordance with this concept, the Air Force sought to discourage and, if possible, to prevent any sort of high-

density residential or commercial development of lands situated with a CNR Zone 3 near a military airport. It was the policy of the Air Force to inform local zoning authorities of its views in this respect and to persuade such authorities, if possible, to restrict the use of lands in a CNR Zone 3 to agricultural or industrial purposes, and not to permit such lands to be used for high-density residential or commercial development.

10. (a) Sometime prior to 1971, the Air Force engaged a competent engineering firm to make noise studies with respect to the aircraft operations at March Air Force Base and to establish CNR zones for the lands within the environs of the base. As a result of these studies, the property was placed in CNR Zone 3 and thus was part of the "greenbelt" which the Air Force sought to have maintained for the protection of March Air Force Base.

(b) Although no scientific measurements of the noise level on the property, resulting from aircraft operations at March Air Force Base, were made in connection with the noise studies mentioned in paragraph (a) of this finding, it was estimated that at a certain phase of an engine warm-up on the base, the noise on the property would reach a level of about 90 decibels. It was expected that such a noise level would interrupt and prevent normal conversation and would significantly interfere with the ability to sleep.

11. In furtherance of the Air Force policy mentioned in finding 9, Colonel Robert L. Cooch, Commander of March Air Force Base, wrote a letter on July 14, 1971, to Norton Younglove, who was a member of the Riverside County Board of Supervisors and who represented the district in which March Air Force Base is located. This letter stated in part as follows:

> During the past several years, and more particularly, within the past one year, an expanding development of the area surrounding and adjacent to March Air Force Base has raised substantial concern over the continuing encroachment and impact of such developments on base airfield operations. If continued in certain areas, this encroachment could eventually adversely affect the mission accomplishment of the base, and eventually might result in either condemnation action to acquire appropriate "restrictive easements" or "purchase" of land by the government for a "protective greenbelt" zone around the base, or if this could not be accomplished, a reduction or transfer of base flying activities could eventually result. To preclude this encroachment, and to protect surrounding areas from nuisance, noise and

other unavoidable hazards of airfield operations, the Air Force has developed a "greenbelt concept," which envisions a buffer zone sufficient to protect airfield operations from such encroachment, and at the same time, reduce citizens' objections resulting from nuisance, noise or other hazards of airfield activities. This concept envisions that at certain large Air Force bases, with a permanent and continuing hard core flying mission, that certain actions should be taken to develop or extend a "greenbelt" area (non-residential—commercial) around such activities to permit their continued, indefinite operation in the future.

March Air Force Base is such an activity which is included within the "hard core flying mission, 'greenbelt' concept." However, the continuing development of the surrounding area into residential areas and commercial developments, does create an immediate concern.

* * * [T]he east side of the base to Perris Blvd., is within the "greenbelt" area requiring encroachment protection. Several tracts in this area are presently being pushed by certain land owners for residential development. * * * To preclude further encroachment on base airfield operations/activities and to protect this area from nuisance, noise and other hazards including "citizens' objections," from the impact of noise and other such airfield hazards, and to assure continued, indefinite and unrestricted AF activities, your assistance is needed to prevent further encroachment. Specifically, three alternatives appear possible:

a. Appropriate zoning by county authorities to retain the area in an agricultural, park or industrial status, thus preventing residential/commercial developments, etc.

* * * * *

The first alternative noted above appears to be the most feasible * * *.

* * * * *

To prevent further continuing encroachment and to assure continued unimpeded mission accomplishment, it is requested that appropriate zoning controls be considered for the mentioned areas adjacent to the base to preclude residential, commercial or other high density development. * * *

12. (a) As stated in previous findings, it was the plaintiff's intention, when it acquired the property in 1963–64, to use the property ultimately for residential development

by building low-cost homes on it. In order to carry out such intention, it was necessary for the plaintiff to obtain from the Riverside County Board of Supervisors a change of zoning for the property, from RA–5 (residential-agricultural, 5-acre minimum) to R–1 (residential, single-family dwellings).

(b) On or about July 28, 1971, the plaintiff filed with the Riverside Planning Commission an application requesting that the zoning of the property be changed from RA–5 (residential-agricultural, 5-acre minimum), which the property had been subject to since 1967, to R–1 (residential, single-family dwellings).

(c) The property had theretofore never been zoned for R–1 use.

13. At the time when the plaintiff submitted the application referred to in finding 12(b), the surrounding land, with the exception of March Air Force Base on the west, was being used for agricultural purposes. There was very little residential development in the area.

14. Having learned of the plaintiff's request that its property be rezoned from RA–5 to R–1, Colonel Robert L. Cooch, Commander of March Air Force Base, sent a letter concerning the matter to Norton Younglove, a member of the Riverside County Board of Supervisors, on August 31, 1971. This letter stated in part as follows:

> * * * This property * * * lies well within the March AFB "greenbelt zone" and the Zone 3 noise level, which, in our view, would make it highly undesirable for any type of residential use. Further, this property lies only a few hundred feet from the Base jet engine runup areas, and as such, is frequently subject to the most intense noise created on the base.
>
> We are, as you know, highly concerned with any residential encroachment to the Base which would increase citizens' complaints, which the noise problem may well be expected to generate. * * *

15. (a) The plaintiff's application for a change of zoning was considered by the Riverside County Planning Commission at a meeting on September 8, 1971. The members of the commission voted unanimously to recommend to the Riverside County Board of Supervisors that the zoning of the property be changed from RA–5 to R–1.

(b) The recommendation of the Planning Commission was transmitted to the Board of Supervisors in the form of a letter dated September 27, 1971.

Findings of Fact

16. A hearing on the plaintiff's application for a change of zoning was held before the Riverside County Board of Supervisors on October 26, 1971. Instead of taking action on the application, the Board of Supervisors voted to continue the hearing to November 16, 1971, and, in the meantime, to refer the application to the Riverside County Airports Land Use Commission for further study and a recommendation.

17. (a) The plaintiff's application for a change of zoning was considered by the Riverside County Airports Land Use Commission at a meeting on November 11, 1971. The Commission voted to support the previous recommendation of the Riverside County Planning Commission that the plaintiff's application for a change of zoning be approved.

(b) By means of a letter dated November 15, 1971, and addressed to the Riverside County Board of Supervisors, the Airports Land Use Commission recommended that the plaintiff's request for a change of zoning be approved in accordance with the recommendation of the Riverside County Planning Commission.

18. (a) A further hearing on the plaintiff's application for a change of zoning was held by the Riverside County Board of Supervisors on November 16, 1971.

(b) At the outset of the hearing, Norton Younglove submitted to the other members of the Board the letter from Colonel Cooch that is mentioned in finding 14.

(c) The Staff Judge Advocate of March Air Force Base appeared at the hearing as the representative of the Base Commander and of the Air Force, and testified in opposition to the application. He reminded the members of the Board that the Government had invested more than $100,000,000 in March Air Force Base and that the Government expended approximately $70,000,000 annually on the operations at the base. The Staff Judge Advocate further stated that it was anticipated by the Air Force that if the area immediately adjacent to the base were developed for high-density residential use, complaints about the noise emanating from the base by individuals and groups of individuals living near the base might ultimately force the Air Force to curtail or discontinue operations at the base; that the property was in CNR Zone 3, which meant that the property was subject to the highest intensity of noise emanating from the base; and that the encroachment of high-density residential development on the property would be incompatible with the continued use of March Air Force Base for military operations at the then-current level.

(d) Except for the Staff Judge Advocate from March Air Force Base, no one appeared at the hearing in opposition to the plaintiff's application for a change of zoning, and no written objections to the application were submitted by anyone other than the Air Force.

(e) During the course of the hearing, Norton Younglove remarked that, quite apart from the problem of the impact of aircraft noise on the property, he questioned whether there was a need for additional R–1 zoning in the area, inasmuch as there was already adequate R–1 zoning in the area and very little actual development of such land for residential use.

(f) At the conclusion of the hearing, with one supervisor absent and one supervisor not voting, the three other members of the Riverside County Board of Supervisors voted to reverse the recommendation of the Riverside County Planning Commission and to deny the plaintiff's application for a change of zoning.

19. The evidence in the record warrants the inference, and it is found, that if the Air Force had not opposed the plaintiff's application for a change of zoning, the application would have been approved by the Riverside County Board of Supervisors.

20. The evidence in the record warrants the inference, and it is found, that the Air Force personnel involved in the opposition to the plaintiff's application for a change of zoning acted in good faith and from the honest belief that the development of the property for high-density residential use would be incompatible with the military mission of March Air Force Base.

21. (a) On November 15, 1971, the date preceding the action of the Riverside County Board of Supervisors in denying the plaintiff's application for a change of zoning, the fair market value of the property, with its RA–5 zoning, was $82,700.

(b) On November 17, 1971, the day following the action of the Riverside County Board of Supervisors in denying the plaintiff's application for a change of zoning, the fair market value of the plaintiff's property, with its RA–5 zoning, was $82,700.

(c) If the plaintiff had been able to secure the requested change of zoning for the property from the Riverside County Board of Supervisors on November 16, 1971, the fair market value of the property, with a new zoning of R–1, on November 17, 1971, would have been $248,200.

Syllabus

22. Although aware at the time of the denial of its application for a change of zoning that judicial review of the action of the Riverside County Board of Supervisors was available, the plaintiff chose not to exercise such right.

23. The plaintiff subsequently submitted a second application for rezoning to the Riverside County Board of Supervisors. However, upon the Board's request that the plaintiff file an environmental impact report, the plaintiff refused and, instead, abandoned its second application.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made part of the judgment herein, the court concludes as a matter of law that the plaintiff is not entitled to recover, and the petition is dismissed.

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551 F.2d 286

JAMES W. BUTLER v. THE UNITED STATES

[No. 55–74. Decided March 23, 1977. Plaintiff's motion for rehearing denied May 27, 1977]

ON THE PROOFS

Contracts; bids; recovery of bid deposit.—Plaintiff sues to recover an earnest-money deposit made in November 1972 in connection with his bid in response to a bid invitation which included a prospectus and a bid package, issued by HUD relating to the sale of a rehabilitated and repaired apartment complex which had been severely vandalized and vacant. After acceptance of plaintiff's bid, plaintiff refused to go to settlement, alleging that the prospectus contained misleading information as to the estimate of the amount of yearly real estate taxes, i.e. $7,494.90, whereas plaintiff learned that they would approximate $17,500. HUD terminated the contract and declared the deposit forfeited as liquidated damages. While the prospectus recited the figure of $7,494.90 for estimated annual taxes, it informed prospective bidders that the figure was the actual total of the annual city and county real estate taxes assessed at a time when the apartments were vacant and severely vandalized and that the local taxing authorities had not reassessed the apartments since completion of the renovation program. For the reasons stated, it is *held* that, though plaintiff misunderstood the situation, the prospectus was not false or misleading and instead, as to the taxes, made the real situation clear. Furthermore, as to certain other potentially misleading defects in the bid package pointed out by

plaintiff in his briefs and at oral argument, there was no showing that plaintiff was actually misled. The court also relied on HUD's express disclaimer of any warranty as to the accuracy of information furnished. Plaintiff is not entitled to recover and the petition is dismissed.

Contracts; bids; bidder's duty to investigate.

[1] This court will not relieve a party to a sale contract with the Government from the consequences of his own inattention and carelessness. Where the means or knowledge are at hand and open to investigation, if the purchaser does not avail himself of these means and opportunities he will not be heard to say that he has been deceived by the Government's misrepresentations. This is particularly so where the Government expressly disclaims any warranty as to the accuracy of information furnished in the bid prospectus.

United States ⚖70(31)

James W. Butler, pro se.

Thomas L. McKevitt, with whom was *Assistant Attorney General Peter H. Taft,* for defendant. *Dennis A. Dutterer,* of counsel.

Before NICHOLS, KUNZIG and BENNETT, *Judges.*

Per Curiam: This case is before the court on plaintiff's exceptions to a recommended decision of Senior Trial Judge Mastin G. White, which he has submitted in accordance with Rule 134(h). After briefing and oral argument, the court agrees with the said recommended decision, as hereinafter set forth and affirms and adopts the decision as the basis for its judgment in this case.

The suit is to recover the sum of $30,000 which plaintiff paid to the Department of Housing and Urban Development (HUD) as earnest money in support of his bid to purchase certain real property. The plaintiff was the highest bidder, but refused to go to settlement, alleging that the prospectus contained misleading information. As stated in the opinion, the major contention was that plaintiff regarded as HUD's best estimate of future annual taxes on the property, a prospectus figure of $7,494.90, which actually reflected the taxes as temporarily reduced during a period when the premises were vacant and severely vandalized. We agree with the Trial Judge that

the prospectus was not false or misleading and instead, as to the taxes, made the real situation clear.

However, in his briefs and oral argument before us, plaintiff also pointed out other defects in the prospectus and bid package furnished him. The prospectus included a figure of $612 per month set down as the cost of guard services. On HUD Form 9657, the bid package included a total operating cost figure of $49,625, not broken down. A worksheet discovered in HUD files shows that various cost elements, not including the guard services, were added to make this figure. A bidder might have inferred that it included at least, among others, all the cost elements mentioned in the prospectus, whereas a statement of all cost elements foreseen by HUD would have added the predicted guard services cost at least to the $49,625 figure. There were also minor discrepancies between the worksheet and the prospectus with respect to the costs of electricity and refuse removal.

The findings clearly set forth plaintiff's mistaken belief that the actual lowered tax figures before rehabilitation were HUD's estimate of future taxes, plaintiff's discovery of the mistake before closing, and his refusal to close in consequence. The record as it comes before us is barren of any corresponding finding as to how he weighed the $49,625 figure, except that he read and executed the form No. 9657, which included it. As the prospectus cost figures totalled only $21,489.06, the higher figure might have taught caution in interpreting the prospectus as readily as it might have fostered the belief that $49,625 was all. In the circumstances, and in face of HUD's express disclaimer of any warranty as to the accuracy of information furnished, we are unable to say that the potentially misleading treatment of the guard services cost, or the minor discrepancies above mentioned, justify us in rejecting the Trial Judge's recommended decision. It will be understood that we are not awarding any accolades to HUD for its management of this transaction.

Accordingly, the plaintiff's exceptions are overruled and the petition is dismissed.

The Trial Judge's opinion follows. His fact findings are not printed, but are available to the parties.

OPINION OF TRIAL JUDGE

WHITE, *Senior Trial Judge:* The plaintiff sues to recover the sum of $30,000, which he paid in November 1972 to the Department of Housing and Urban Development ("HUD") as an earnest-money deposit in support of his bid for the purchase of the Cedar Courts Apartments ("the apartments"), located in Memphis, Tennessee.

The apartments, which were acquired by HUD in 1969, are located approximately 2 miles from the downtown area of Memphis. They consist of 17 2-story buildings, containing a total of 114 2-bedroom units, and a commercial building that contains office space and a large self-service laundry.

When HUD acquired the apartments in 1969, they were vacant and uninhabitable, having been severely vandalized. By June 1, 1972, however, the apartments were in good condition, as they had been rehabilitated and repaired by HUD at a cost of $230,000 during the period of HUD's ownership.

The plaintiff's bid for the purchase of the apartments was submitted in response to an invitation for bids which HUD issued on or about September 29, 1972, through the publication of a document entitled "This is Your Prospectus and Invitation to Bid" ("the prospectus"). The prospectus stated that sealed bids for the purchase of the apartments would be received and would be publicly opened at 11 a.m. on November 29, 1972. The prospectus also stated that the minimum acceptable bid would be $700,000.

The plaintiff's bid was submitted within the time specified; it was in the amount of $757,000; and, as previously indicated, it was supported by a $30,000 earnest-money deposit.

On December 12, 1972, the plaintiff's bid for the purchase of the apartments was accepted by HUD, and the Secretary of HUD executed the formal contract of sale and purchase which the plaintiff had previously executed in connection with the submission of his bid. Some 3 days later, on December 15, 1972, the plaintiff was informed by

HUD that the sale of the apartments must be closed by midnight of February 12, 1973.

The plaintiff, however, later refused to go to settlement under the contract for the sale and purchase of the apartments. HUD then, on February 20, 1973, declared the contract to be terminated and the plaintiff's earnest-money deposit of $30,000 to be forfeited as liquidated damages for the plaintiff's failure to perform the contract.

The plaintiff's refusal to consummate the contract was based upon the plaintiff's conclusion that the prospectus contained misleading information on the subject of taxes.

Under the heading of "Approximate Expenses," the prospectus listed certain expense items, with an amount for each item. One of the items was "Taxes Per Yr.," and the amount set out for this item was $7,494.90. The plaintiff testified, in effect, that he regarded the figure of $7,494.90 as HUD's best estimate as to what the annual taxes on the apartments would be for the purchaser, although he believed there might be an error of from 10 to 20 percent in HUD's estimate and, to that extent, he took the possibility of an annual tax expense greater than $7,494.90 into account in computing his bid for the purchase of the apartments.

After the plaintiff had submitted his bid and entered into the contract for the purchase of the apartments, he learned for the first time that on September 30, 1969, HUD had requested the Shelby County Assessor of Property (the apartments are located in Shelby County, Tennessee) to reassess the apartments and reduce the then-current appraised value from $500,000 to $301,000, on the ground that the property was severely vandalized, uninhabitable, and vacant; that on October 21, 1969, the Shelby County Assessor of Property had informed HUD that the apartments had been reassessed downward in accordance with HUD's request; and that, on the basis of the rehabilitation of the apartments during 1971–72, it was expected by the management broker in charge of the apartments that the apartments would be reassessed upward and the real estate taxes on the apartments for 1973 would probably amount to about $17,500. (The apartments actually were reassessed

later, as expected, and the real estate taxes for 1973 amounted to $17,711.20.)

Because of the discrepancy between the figure of $7,494.90 for taxes set out in the prospectus under the heading of "Approximate Expenses" and the figure of $17,500 which the plaintiff learned would probably be the approximate amount of the real estate taxes on the apartments for 1973, the plaintiff refused to close the sale of the apartments by midnight of February 12, 1973, as required by the provisions of the contract between HUD and the plaintiff. Thereafter, HUD forfeited the $30,000 earnest-money deposit which the plaintiff had made in support of his bid for the purchase of the apartments, thus setting the stage for the present litigation.

In connection with the matter of taxes on the apartments, the evidence in the record shows that HUD in June 1972, prior to the publication and issuance of the prospectus, had prepared an income analysis and appraisal relative to the apartments on FHA Form No. 2264; that this calculation was made in order to determine the minimum acceptable bid price for the apartments ($700,000 was the figure determined by HUD); that the calculation included an estimate of the annual expenses that would probably be incurred by the purchaser of the apartments; and that, in the computation, HUD estimated that the annual expenses would include real estate taxes in the amount of approximately $13,125.

HUD's action in listing the figure of $7,494.90 for annual taxes in the prospectus under the heading of "Approximate Expenses," when HUD's actual estimate at the time concerning the amount of future real estate taxes on the apartments was $13,125 per year, would seem on superficial consideration to have been the sort of misleading information which, if relied on by the successful bidder, would justify the latter in rescinding the contract for the purchase of the apartments and demanding the return of his earnest-money deposit.

The figure of $7,494.90 in the prospectus, however, was followed by a footnote reference designated as "(2)," and this footnote stated as follows:

(2) 1971–72 Real Estate Taxes: City $3,205.65; County $4,289.25. The property has not been reassessed by the local taxing authorities since the completion of the rehabilitation.

Also, the prospectus contained the following additional statement that should be considered in this connection:

Project was held vacant pending completion of a rehabilitation program by HUD. Rental program commenced June 1, 1972. * * *

The prospectus material quoted in the two immediately preceding paragraphs clearly informed prospective bidders that the figure of $7,494.90 for annual taxes did not represent an estimate concerning future taxes but, rather, was the actual total of the annual city and county real estate taxes assessed against the apartments for the years 1971 and 1972; that such taxes had been assessed against the apartments at a time when the apartments were vacant and in the process of being rehabilitated; and that, although the rehabilitation program had been completed and the apartments were ready for rental by June 1, 1972, the apartments had not been reassessed by the local taxing authorities since the completion of the rehabilitation. This should have been sufficient, in my opinion, to alert an ordinarily prudent investor, who was considering the submission of a bid for the purchase of the apartments, regarding the advisability of investigating the tax situation prior to the submission of his bid.

Anyone interested in investigating the tax situation relative to the apartments could have examined the public records of the Shelby County and Memphis taxing authorities. Such an investigation would have revealed that for the year 1969 the assessed valuation of the apartments was $250,000 (representing 50 percent of the fair market value of $500,000), and the city and county real estate taxes for 1969 totaled $11,475; that on October 21, 1969, pursuant to a request (and the only reasonable inference was that the request was submitted by or on behalf of HUD as the owner), the apartments were reappraised for the tax year 1970; that the property had been inspected in connection with the reappraisal and had been found "to be completely vacant and boarded up," with the "Interior damaged badly

and all windows broken out"; that the assessed valuation for 1970 was reduced from the previous figure of $250,000 to $150,500 (representing 50 percent of the reappraised value of $301,000); that on the basis of the reappraisal and reassessment, the city and county taxes on the apartments were reduced from $11,475 per year to $7,494.90 per year; that on February 15, 1971, a building permit was obtained for the renovation of the apartments at an estimated cost of $100,000; and that the assessed valuation of $150,500 was still in effect when the prospectus was issued. Also, as previously indicated, the prospectus itself informed prospective bidders that the renovation program had been completed and the rehabilitated apartments were ready for rental by June 1, 1972, but that the local taxing authorities had not reassessed the apartments since the completion of the renovation program.

In view of (1) the information which was set out in the prospectus itself, and (2) the information which was readily available in the public records of the local taxing authorities, the conclusion seems inescapable that the plaintiff was careless in concluding, without looking into the matter further, that the real estate taxes on the apartments for 1973 would not be more than 10 or 20 percent greater than the figure of $7,494.90 set out in the prospectus as the total annual amount of the city and county real estate taxes for 1971 and 1972.

As this court said in *Snyder Corp.* v. *United States*, 68 Ct. Cl. 667, 676 (1930):

> * * * This court will not relieve a party from the consequences of his own inattention and carelessness. Where the means or knowledge are at hand and open to inspection, if the purchaser does not avail himself of these means and opportunities he will not be heard to say that he has been deceived by the vendor's misrepresentations. * * *

Although the plaintiff's petition relies only on the alleged misrepresentation concerning taxes in the prospectus as the basis for recovery, the plaintiff's brief appears to place some reliance also on the circumstance that the prospectus, under the heading of "Approximate Expenses," did not include certain estimated expenses which HUD

took into account in computing the minimum bid price that would be regarded as acceptable.

With respect to this point, it should be mentioned that the plaintiff, in addition to receiving the prospectus, also received from HUD and considered, prior to the submission of his bid, a "bid package" which included (among other things) a HUD Form No. 9657, and the HUD Form No. 9657 contained a statement to the effect that HUD estimated "the cost of operation, maintenance, taxes and reserve for replacement deposits" to be $49,625. The $49,625 figure was the total of the estimated expenses which HUD had used in computing the amount of the minimum acceptable bid, and the statement in HUD Form No. 9657 put prospective bidders on notice that the expenses mentioned in the prospectus under the heading of "Approximate Expenses," totalling $21,489.06, did not constitute an exclusive list of all the expenses which the purchaser might reasonably expect to incur in operating the apartments.

Furthermore, it should have been fairly obvious to a knowledgeable investor that the expenses listed in the prospectus did not represent an all-encompassing list. The listed expenses were taxes, utilities, guard service, garbage removal, and reserve for replacement deposits. The list did not include such things as manager's salary, employees' wages, decorating, repairs, insurance, and advertising, all of which were reasonably to be expected as expenses involved in the operation of an apartment complex containing 114 residential units. Consequently, it was not reasonable of the plaintiff to believe that the expenses listed in the prospectus, totaling $21,489.06 and covering only the items of taxes, utilities, guard serivce, garbage removal, and reserve for replacement deposits, represented all the expenses that would be involved in the operation of the apartments.

For the reasons previously stated in this opinion, the plaintiff is not entitled to recover and the petition is dismissed.

Syllabus

551 F.2d 295

FRANK P. SILVER v. THE UNITED STATES

[No. 449–72. Decided March 23, 1977]

ON THE PROOFS

Military pay; active duty pay; physicians' and dentists' premium pay; offset for outside earnings.—Plaintiff, a physician engaged in private practice at the time he was ordered to active duty in the Army Medical Corps, sues to recover pay and allowances including premium pay authorized by 37 U.S.C. § 302(b)(1) for the period June 5, 1968 to March 21, 1969 when he was in active duty status although he rendered the Army no medical services because of injuries sustained in an automobile accident which occurred prior to his being called up. However, plaintiff engaged in private practice of medicine during the period in issue. Defendant agrees that plaintiff is entitled to regular pay plus allowances, but disputes his entitlement to premium pay. It is *held* that for purposes of this decision plaintiff is entitled to both his regular pay and allowances and the premium pay. It is also *held* that plaintiff's gross military compensation is subject to reduction by the amount of his outside medical earnings, and, since the latter exceeds the former, he is denied affirmative recovery. The petition is dismissed.

Military pay; active duty pay; special pay; physicians and dentists; congressional intent.

[1] In enacting 37 U.S.C. § 302, Congress did not condition physicians' and dentists' premium pay on actual rendition of professional services, but solely on appointed status.

Armed Services ⚖13.1(7)

Military pay; active duty pay; computation of pay; outside earnings.

[2] In a suit for back pay, a claimant's outside earnings are to be deducted from an award if such earnings would not have been received by him had he been rendering the Government the employment services called for by the position for which he is found to have been improperly denied compensation. This is on the theory that the Government is due the employee's entire productive efforts during the hours for which he received pay as an employee, whether the Government is paying for the employee's time currently or retroactively.

Armed Services ⚖13.6(1)

Military pay; active duty pay; special pay; physicians and dentists; offsets.

[3] Where plaintiff, after appointment to active service with the Medical Corps, was unable to perform his duties as a Corps physician because of injuries sustained in an automobile accident prior to being called up, but did engage in private practice of medicine during the period in issue, while he is entitled to regular pay and to premium pay

pursuant to 37 U.S.C. § 302, his gross compensation attributable to services rendered during regular military duty hours is subject to reduction to the extent of his earnings from his civilian medical practice.

Armed Services ⟸13.6(1)

James J. Orlow, attorney of record, for plaintiff.

Donnie Hoover, with whom was *Acting Assistant Attorney General Irving Jaffe,* for defendant.

Before COWEN, *Senior Judge,* DAVIS and SKELTON, *Judges.*

PER CURIAM: This case comes before the court on plaintiff's exceptions to the recommended decision of Trial Judge George Willi, filed May 26, 1976, pursuant to Rule 134(h). Upon consideration thereof, together with the briefs and oral argument of counsel, since the court agrees with the trial judge's recommended decision, as hereinafter set forth, it hereby affirms and adopts the said decision as the basis of its judgment in this case. It is, therefore, concluded that plaintiff is not entitled to recover and the petition is dismissed.

OPINION OF TRIAL JUDGE

WILLI, *Trial Judge:* Plaintiff, a physician who was engaged in the private practice of obstetrics and gynecology at the time that he was ordered to active duty as a Reserve Captain in the U.S. Army Medical Corps, sues to recover the pay and allowances for that grade for the time that he was in active duty status although unable to perform the duties of a Medical Corps physician because of injuries sustained in an auto accident that occurred prior to his being called up. The defendant now agrees that plaintiff is entitled to captain's pay plus subsistence and quarters allowances totaling $8,359.92 for the period in issue, June 5, 1968 to March 21, 1969. This is the amount that plaintiff claims for these items. Defendant denies, however, that plaintiff is equally entitled to an additional amount of $956.78, representing the $100 per month professional pay authorized by 37 U.S.C. § 302(b)(1) (1970) for a reserve

officer called to active duty in the Army Medical Corps for a period of more than 1 year, as plaintiff was. Defendant contends that plaintiff is not entitled to such premium pay since it is undisputed that, because of his disability, he rendered the Army no medical service while in active duty status. The difficulty with that argument is that while Congress certainly could have conditioned entitlement on the actual rendition of professional services, it did not do so. Instead, the unambiguous language of the statute predicates eligibility solely on appointed status, which plaintiff admittedly had. It is therefore held for purposes of this decision that plaintiff is due the gross amount of $9,316.70 for his period of active duty. That determination sets the stage for the real and subsisting dispute between the parties, *viz*, the extent to which, on the facts presented,[1] the gross entitlement is subject to reduction to the extent of plaintiff's earnings from the private practice of medicine during his period of active duty. In that regard, the parties' differences are primarily legal rather than factual, plaintiff contending that the outside earnings principle has application only to a period of constructive service following a wrongful separation,[2] not to a time of actual employment on active duty as here involved.

This court has uniformly held that a claimant's outside earnings are to be deducted from an award of back pay if such earnings would not have been received by him had he been rendering the Government the employment services called for by the position for which he is found to have been improperly denied compensation. *Jackson* v. *United States*, 121 Ct. Cl. 405, 414 (1952); *Jaffe* v. *United States*, 124 Ct. Cl. 755 (1953); *Getzoff* v. *United States*, 124 Ct. Cl. 232, 236–38, 109 F.Supp. 712, 714-15 (1953). The test simply recognizes that when the Government has a man on its payroll it is entitled to his undivided attention during working hours. From that standpoint it makes no difference whether the Government is paying for the employee's time currently or

[1] A detailed statement of the facts is set forth in the separately numbered findings of fact, *infra*. The factual essentials of the decision are contained herein.

[2] *Motto* v. *United States*, 175 Ct. Cl. 862, 360 F.2d 643 (1966); *Clackum* v. *United States*, 161 Ct. Cl. 34, 36 (1963); *Garner* v. *United States*, 161 Ct. Cl. 73, 75 (1963); *Egan* v. *United states*, 141 Ct. Cl. 1, 27, 158 F.Supp. 377, 392 (1958).

retroactively. In either case it is due his entire productive efforts during the hours for which he receives pay as an employee.

In resisting cognizance of private practice earnings in determining the ultimate amount of his permissible recovery, plaintiff relies on two Supreme Court decisions, *United States* v. *Williamson*, 90 U.S. 411 (1874) and *Bell* v. *United States*, 366 U.S. 393 (1961). Both announced the general proposition that military service pay is fixed by statute, a matter not here disputed, and neither involved any qualification on the serviceman's right to such pay by reason of earnings from concurrent outside employment. It is true that in rejecting the Government's contention in *Bell, supra*, that by analogy to damage principles governing breach of contract a serviceman guilty of disloyalty forfeited his right to pay, the Court noted that "* * * it is to be observed that common-law rules governing private contracts have no place in the area of military pay." 366 U.S. at 401. As previously explained, however, a reduction of military pay to take account of earnings received for services that could not have been rendered compatibly with the military service for which pay is otherwise found to be due, implicates no common law contract principles remotely resembling those to which the Court alluded in *Bell, supra*.[3]

The active duty period here involved is June 6, 1968 to March 21, 1969. In the calendar years 1968 and 1969 plaintiff earned a total of $104,941 from his civilian medical practice. Finding 14, *infra*. Of that total it has been found on the evidence presented that not less than $9,316.70 was attributable to services rendered by him during regular military duty hours in the period involved. Ultimate Finding of Fact, *infra*. It is therefore concluded that plaintiff must be denied affirmative recovery.

FINDINGS OF FACT

1. Plaintiff is a physician who received his M.D. degree from the Jefferson Medical College in Philadelphia, Penn-

[3] Unlike *Bates* v. *United States*, 197 Ct. Cl. 35, 453 F.2d 1382, (1972), there is here no claim of a service regulation or practice providing against deduction of civilian earnings.

sylvania, on June 16, 1961. After completing a 12-month internship at Philadelphia's Nazareth Hospital in 1962, he served a 36-month residency in obstetrics and gynecology at Episcopal Hospital in Philadelphia. He became licensed to practice in Pennsylvania on July 1, 1965, and thereupon proceeded to establish a private practice in those specialties in the Philadelphia area.

2. Dr. Silver had received a draft deferment in order to complete his medical studies. After completing those studies he was given the choice by his draft board of volunteering to accept a Captain's commission in the U.S. Army Medical Reserve Corps or taking his chances on being drafted into the service as an enlisted man. Acceptance of the former option rendered plaintiff liable for call-up for a 2-year period of active duty.

3. Plaintiff volunteered to accept a reserve commission and, to that end, underwent a preinduction physical examination on November 8, 1965. He was found physically fit and otherwise qualified for a reserve commission in the Army as a Captain in the Medical Corps.

4. In March 1966 plaintiff was involved in an accident in which he was thrown from an automobile with a resultant injury to his lower back. He was hospitalized for a week or 10 days on this account. The back problem, which was diagnosed as a herniated spinal disc, curtailed his obstetrical practice because of his inability to bend forward without considerable discomfort.

5. By an Army form dated April 1, 1966, plaintiff was notified of his appointment as a Reserve Captain and requested to execute and return an oath of office. He did so on April 4, 1966. Plaintiff does not suggest, and it does not otherwise appear that when he was tendered his reserve commission he informed the Army that since his preinduction physical he had sustained an injury that might render him physically unfit for appointment.

6. Albeit with some discomfort and impairment of activity resulting from his back injury, plaintiff continued to conduct his private medical practice with some part-time assistance from a young doctor named Cogan who was working in an area hospital as a resident in obstetrics and gynecology. Dr. Cogan completed his residency on July 1, 1967, and at that time joined plaintiff as an employee-assistant under an understanding whereby he was to retain that status for 1 year and then, on a progressive basis over the next 4 years, succeed to a full partnership interest in the practice. That timetable was accelerated to 2 years in the summer of 1968 when it became apparent that Dr. Cogan would have to perform the bulk of the work entailed in the partnership practice.

Findings of Fact

7. During the 2-year period following his automobile accident plaintiff remained under observation by a group of orthopedic surgeons who prescribed various types of therapy and treatment designed to enable him to function without the necessity for surgical intervention; something that plaintiff was extremely anxious to avoid. He slept on a bed board, wore a spinal brace at night, maintained a heat treatment device, called a hydrocolator pack, at his home and received physiotherapy treatments at various area hospitals as an outpatient.

8. In early 1968 plaintiff developed some weakness in his left foot. Although this was a manifestation of progressive neuropathy, a reliable indication of the need for corrective spinal surgery, plaintiff still resisted the surgical approach. Instead, he received cortisone injections in his spine to alleviate nerve swelling and thereby correct the foot drop.

9. Army orders were issued plaintiff on April 9, 1968, directing him to report to Fort Devens, Massachusetts, for active duty as a Captain in the U.S. Army Medical Corps not later than June 1, 1968. He did not so report because on that date he was confined to the Holy Redeemer Hospital in Philadelphia for treatment of an allergy problem that caused coughing so severe that it produced extreme pain in the left leg that had been affected by his back problem. On June 5, 1968, pursuant to his activation, plaintiff was removed from Holy Redeemer and transported by Army ambulance to the U.S. Army Valley Forge General Hospital at Phoenixville, Pennsylvania.

10. At Valley Forge plaintiff's condition was diagnosed as herniated low lumbar disc syndrome, and he was placed on a regimen that consisted primarily of bed rest, physical therapy and moist heat. A clinical report of July 18, 1968, by the Army physician attending the plaintiff, concluded with the following recommendation:

> This patient has been under observation and conservative care at Valley Forge General Hospital since his admission and it has become obvious that he has definite disability referable to the low back. On the basis of all of the material gathered including the letter from his attending Orthopedic Surgeon, the Neuro-Surgical consultation obtained here and the findings of physical examination, it is considered that this man could not function effectively as a physician in the Medical Corps.
> Under the regulations of AR 635–105, Section 2–14c, this patient should be released from active duty.

* * * * *

11. Plaintiff remained at Valley Forge until July 26, 1968, when he was granted a 30-day convalescent leave to be spent at his home. While at Valley Forge plaintiff was assigned no medical duties and performed none, other than some informal psychiatric counseling of amputees which he undertook purely on his own. During his stay at Valley Forge, for which he was charged only his daily subsistence allowance of $1.75, plaintiff consulted extensively by telephone with Dr. Cogan concerning the treatment of patients under the latter's care.

12. Plaintiff remained on successive periods of 30-day convalescent leave at all times after July 26, 1968, until his honorable discharge for physical disability on March 21, 1969. By orders of July 31, 1968, plaintiff's duty station was changed from Fort Devens, Massachusetts, to the Medical Holding Company at the Valley Forge Hospital. Other than periodically appearing to renew his leave, his only further contact with the military after July 26, 1968, was when he presented himself at Valley Forge General Hospital on January 27, 1969, to undergo a Medical Evaluation Board physical examination. On February 3, 1969, the Board unanimously recommended that the Physical Evaluation Board declare the plaintiff unable to function effectively as a physician in the Medical Corps.

13. Other than during December 1968 when he went to the Bahamas and Jamaica on a vacation (with the approval of the military authorities) plaintiff was either consulting with Dr. Cogan by telephone from his home or was at their office. During the months of August and September 1968, plaintiff's activities in his practice were largely limited to telephone consultations from his home. Plaintiff testified that all of such professional consultations, as well as those that occurred while he was a patient at Valley Forge, took place during daytime hours. He was back in his office in October and November 1969, and during that portion of 1969 preceding his discharge on March 21. After returning to his office, in addition to treating patients there, plaintiff performed some surgery.

14. According to his federal individual income tax returns plaintiff earned $28,157 from his own medical practice in 1968 and, in addition earned $12,277 from the medical partnership that he had formed with Dr. Cogan in the summer of 1968. Plaintiff's 1969 return disclosed a net profit of $32,458 from his own medical practice and $32,049 as his share of the profits from his partnership with Dr. Cogan. In testifying at the trial about his 1968 and 1969 earnings from the private practice of medicine plaintiff referred only to income that, according to his returns, was derived from his individual practice. He completely over-

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looked income of more than $44,000 that he received from his partnership with Dr. Cogan during those 2 years.

15. The parties are agreed that plaintiff was on active duty with the Army as a captain from at least June 5, 1968 to March 21, 1969, and that for that period he is entitled to basic pay of $6,659.65, quarters allowance of $1,242.15 and subsistence allowance of $458.12. Although defendant denies plaintiff's entitlement to professional pay under 37 U.S.C. § 302 (1970) for that period, it agrees that if he were found entitled to such pay the amount thereof would be $956.78.

ULTIMATE FINDING OF FACT

On the basis of the evidence adduced at trial, including plaintiff's own account of his activities in the private practice of medicine during the period of June 5, 1968 to March 21, 1969, and the information reflected by his 1968 and 1969 individual income tax returns it is concluded he earned not less than $9,316.70, the gross amount of pay and allowances for which he contends in this suit, for medical services rendered by him during that period.

CONCLUSION OF LAW

Upon the trial judge's findings and opinion, which are adopted by the court, the court concludes as a matter of law that plaintiff is not entitled to recover and the petition is dismissed.

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553 F.2d 69

LOCKHEED AIRCRAFT CORPORATION v. THE UNITED STATES

[No. 382-70. Decided March 23, 1977]

ON THE PROOFS

Patents; infringement; validity; license.—Plaintiff seeks, pursuant to 28 U.S.C. § 1498, reasonable and entire compensation for the unauthorized manufacture and use by or for the Government of an airborne radar system for detecting the height, range and relative azimuth position of a remote target, disclosed and claimed in U.S. Patent No. 3,001,191 owned by plaintiff. Defendant asserts that the

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patent is invalid and not infringed, and that it acquired a royalty-free license to use the invention as a result of certain provisions in a contract between plaintiff and the Department of the Navy. For the reasons stated, it is *held* that claims 1, 2, 4, 5 and 7 to 10 are valid and that the inventions covered by claims 1, 2, 4, 5 and 8 to 10 have been used and/or manufactured by or for defendant without authorization or license from plaintiff. Claim 7 is not infringed. Plaintiff is entitled to recover, the amount of recovery to be determined pursuant to Rule 131(c)(2).

Pleading and practice; defenses; failure to brief or argue.

[1] An affirmative defense, such as patent misuse, is deemed to have been abandoned where the defendant has neither proposed findings of fact with respect thereto nor addressed misuse in its brief.

Courts ⚖463

Patents; evidence; burden of proof; conception and reduction to practice.

[2] The burden of proof of an inventor's alleged conception and reduction to practice is a heavy one requiring full corroboration by other than the inventor's own self-serving testimony or records. Oral recollections of long past events, unsupported by contemporaneous documentary evidence, are insufficient to meet the strict burden of proof required.

Patents ⚖91(3)

Patents; anticipation; generally.

[3] For a teaching to anticipate an invention under 35 U.S.C. § 102, it is necessary to show each and every element of the claimed combination.

Patents ⚖51(1)

Patents; evidence; burden of proof; prior invention, use or knowledge.

[4] The party asserting prior invention, use or knowledge of the subject matter in suit is required to furnish clear and satisfactory proof thereof beyond a reasonable doubt.

Patents ⚖62(3)

Evidence; weight and sufficiency of; generally.

[5] Oral testimony of witnesses, speaking only from memory in regard to past transactions, in the absence of contemporaneous documentary or physical evidence, is of little probative value. Such uncorroborated testimony is insufficient to show anticipation, within the meaning of 35 U.S.C. § 102, of an issued patent.

Patents ⚖62(2)

Patents; evidence; weight and sufficiency of; generally.

[6] The uncorroborated testimony of prior inventors or users should be evaluated with particular caution, as should the oral testimony of an employee of a party to the litigation, recollecting events long past.

Patents ⚖62(2)

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Patents; patentability; obviousness; generally.

[7] Claims of a patent measure the invention and a resolution of the obviousness of an invention, within the meaning of 35 U.S.C. § 103, must be based on what is claimed. In determining obviousness or nonobviousness of an invention, the scope and content of the prior art is to be determined, the differences between the claims and the prior art are to be ascertained and the level of ordinary skill in the pertinent art is to be resolved.

Patents ⊂⊃18

Patents; anticipation; prior art or publication.

[8] Where the evidence shows that the invention disclosed in the patent in suit was conceived as early as October 28, 1954 and that the inventor was diligent until the application was filed on March 28, 1955, a classified document bearing a date of November 15, 1954 and a patent whose invention conception date was February 9, 1955, are not part of the pertinent prior art with respect to the invention in suit.

Patents ⊂⊃66(3)

Patents; patentability; aggregation or combination of old elements.

[9] A combination of elements well-known at the time of the invention must be viewed as a whole in arriving at a determination as to patentability of the claimed subject matter.

Patents ⊂⊃25, 26(1¼)

Patents; patentability; aggregation or combination of old elements.

[10] A combination of old elements to produce a new and useful result is patentable.

Patents ⊂⊃26(1¼)

Patents; patentability; publications; classified documents.

[11] While reports which were classified at the time the patent in suit was issued are not prior art within the meaning of 35 U.S.C. §§ 102 or 103, they are indicative of the general level of skill in the art.

Patents ⊂⊃70

Patents; patentability; obviousness; delay and failure of others to produce invention.

[12] Where it is shown that the idea of the invention was not apparent to persons trained and skilled in the particular art to which it relates, and familiar with the type of apparatus which the invention involves, it is appropriate to conclude that the invention was not obvious to the ordinary man skilled in the art.

Patents ⊂⊃18

Patents; patentability; obviousness; delay and failure of others to produce invention.

[13] Further evidence of nonobviousness of a patented invention is the long-felt need therefor and the failure of others to provide a satisfactory solution.

Patents ⊂⊃16.7, 36(1)

Syllabus

Patents; infringement; claims define invention.

[14] The claims of a patent define the metes and bounds of an invention and must be looked to in determining if there has been infringement. However, the scope and breadth of the claimed subject matter must necessarily be established before the question of infringement can be resolved.

Patents ⚖165(2), 226

Patents; claims; construing and interpreting; specification and drawings.

[15] While the specification and drawings of a patent may lend aid to interpreting its claims, claims are not limited in scope to the best mode or to any particular mode for practicing the invention described in the specification or drawings.

Patents ⚖167(1)

Patents; specification and claims; construing and interpreting; generally.

[16] A patent should be accorded a liberal interpretation where it discloses not just an improvement in the existing art, but rather a different route yielding a basic solution to a long-existing problem.

Patents ⚖157(1)

Patents; claims; claims reciting "means".

[17] Where a patent claim clause does not recite means responsive *only* or *solely* to range and time difference outputs, but merely expressly requires at least those two factors, it is not of closed construction, and may embrace an element which responds to range, time difference and own altitude for height computation.

Patents ⚖191(8)

Patents; claims; scope.

[18] It is fundamental that patent claims are to be construed in the light of the specifications and both are to be read with a view to ascertaining the invention.

Patents ⚖157(2), 167(1)

Patents; claims; claims reciting "means plus function".

[19] A patent claim's clause comprising a "means" plus a statement of function is governed by 35 U.S.C. § 112, para. 3. While it is essential where "means" clauses are utilized to look to the specification to establish the structure covered, it is also imperative that para. 2 of Sec. 112 requiring that the claims of a patent particularly point out and distinctly claim the subject matter that the applicant regards as his invention, not be totally ignored. A "means plus function" claim covers the structure necessary to perform the specified function.

Patents ⚖191(8)

Patents; specification and claims; construing and interpreting; generally.

[20] It is proper to look to the patent specification in interpreting the claims, even if such a review results in a narrower interpretation of the claims than the broad "means plus function" clauses of the claims

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would at first indicate. The specification needs to be looked to as the concordance for the claims.

Patents ⚖167(1¼)

Patents; claims; claims reciting "means".

[21] Where a claim sets forth a means for performing a specific function, without reciting any specific structure for performing that function, the structure disclosed in the specification must be considered, and the patent claim construed, to cover both the disclosed structure and equivalents thereof.

Patents ⚖101(8)

Patents; infringement; substitution of equivalents; generally.

[22] Equivalency between a claimed and an accused device is established where a person reasonably skilled in the art would have known of the interchangeability of an element or part not disclosed in the patent with one that was.

Patents ⚖237

Patents; infringement; improvement of invention.

[23] Infringement is not avoided simply because an accused device constitutes an improvement of the claimed invention.

Patents ⚖240

Patents; infringement; substitution of equivalents; generally.

[24] Equivalency may be shown by the prior art.

Patents ⚖237

Patents; anticipation; prior art or publication; presumption of knowledge.

[25] Prior art is presumptively known to the hypothetical man skilled in the art, even though its teachings are not generally known in the industry to which it relates.

Patents ⚖58

Patents; specification; sufficiency of disclosure.

[26] A patentee need disclose only the best mode conceived by him for practicing the invention, not all conceivable modes; to require otherwise would place an unreasonable burden on the patentee not required by 35 U.S.C. § 112. Infringement is not avoided by an equivalent that was not known at the time of the invention. Where the inventor was not "personally familiar" with pulse compression when he conceived the subject invention and the patent appropriately reflects what he conceived to be the best mode at that time, equivalency is not vitiated.

Patents ⚖101(4), 237

Patents; infringement; claims; single means/separate means.

[27] The use of a single means to perform the same function in the same manner as two separate means does not avoid infringement.

Patents ⚖234

Patents; license; invention related to Government contract.

[28] To support a contention that the Government was licensed under the patent in suit as a result of a contract between plaintiff-owner and the Department of the Navy, the Government must do more than

broadly allude to various connections between the invention and the contract—it must supply hard facts establishing close and umbilical relationship to the work and research funded by the United States.
United States ⚖97

Patents; license; construction and operation; contemporaneous construction of parties.

[29] Where the contractual language which the Government contends entitled it to a royalty-free license is unclear and suggests several speculative interpretations, the scope of the language must be read in accordance with the parties' contemporaneous construction; extrinsic evidence is admissible to show what the parties intended it to mean.
United States ⚖97

Patents; license; construction and operation.

[30] That the Navy was at least constructively notified of the subject invention and the Navy's contract file contained a statement signed by a Government official that the subject patent and royalty requirements of the contract between plaintiff and the Navy had been complied with by plaintiff, lends credence to the conclusion that the invention was not felt to come within the scope of work called for by the contract nor contemporaneously viewed as such by the parties.
United States ⚖97

William D. Hall, attorney of record, for plaintiff. *Geoffrey R. Myers,* of counsel.

Steven Kreiss, with whom was *Acting Assistant Attorney General Irving Jaffe.*

Before COWEN, *Senior Judge,* DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG and BENNETT, *Judges, en banc.*

PER CURIAM: This case comes before the court on defendant's exceptions to the recommended decision of Trial Judge Joseph V. Colaianni, filed April 20, 1976, pursuant to Rule 134(h), having been submitted on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's recommended decision with a modification, as hereinafter set forth*, it hereby affirms and adopts the said decision, as modified, as the basis for its judgment in this case. It is, therefore, concluded that claims 1, 2, 4, 5 and 7 to 10 of

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* Whereas the court adopts the trial judge's separate findings of fact which are set forth in his report filed April 20, 1976, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

United States Letters Patent No. 3,001,191 are valid and the inventions defined by claims 1, 2, 4, 5 and 8 to 10 have been used and/or manufactured by or for defendant without authorization or license from plaintiff, that plaintiff is entitled to recover reasonable and entire compensation therefor, and judgment is entered for plaintiff to that effect. The amount of recovery will be determined pursuant to Rule 131(c)(2).

OPINION OF TRIAL JUDGE

COLAIANNI, *Trial Judge:* Plaintiff seeks, pursuant to 28 U.S.C. § 1498, reasonable and entire compensation for the unauthorized manufacture and use by or for the Government of a radar for determining the altitude of remote objects. The patent in suit, United States Letters Patent No. 3,001,191 (hereinafter referred to as either the Richter or '191 patent), entitled "Height Finding Radio Detection and Ranging Device," issued to Elvin O. Richter on September 19, 1961, on an application filed in the United States Patent Office on March 28, 1955. Plaintiff, Lockheed Aircraft Corp., has been and continues to be the sole owner of the patent in suit. Infringement of claims 1, 2, 4, 5 and 7 to 10 is alleged.

Defendant has asserted a host of defenses to plaintiff's action, specifically: invalidity, noninfringement, license and misuse. Since no findings of fact have been proposed with respect to the misuse defense and defendant has not addressed misuse in its brief, defendant is deemed to have abandoned its assertion of misuse. *Bendix Corp.* v. *United States,* 186 USPQ 289 (Trial Div., Ct.Cl. 1975); *Grover* v. *United States,* 200 Ct.Cl. 337, 354 (1973).

The issue of accounting was, by order of the Trial Judge, deferred until after the issue of liability is finally adjudicated.

For the reasons stated hereinafter, it is concluded that claims 1, 2, 4, 5 and 7 to 10 are valid and the inventions covered by claims 1, 2, 4, 5 and 8 to 10[1] are found to have been used and/or manufactured by or for the defendant without authorization or license from plaintiff.

[1] Claim 7 is found to be not infringed for reasons stated more fully hereinafter.

The Patent in Suit

The patent in suit relates to an airborne radar system for detecting the height, range and relative azimuth position of a target.

The system relies on the phenomena which occur when a radar beam which has been radiated into space encounters a target. Specifically, what occurs is that the radiated energy reflected off the target within the beam will return to the radar by means of at least two paths, one directly from the target to the radar and the other indirectly from the target to the ground and ultimately to the radar. Since the ground-reflected return energy will travel a further distance than the direct energy, it will arrive at the radar a short time after the directly reflected energy.

By measuring the path length or time difference between the direct and indirect ground-reflected energy, Richter was able to determine target height according to the relationship

$$h_2 = \frac{\triangle TR_S}{2h_1}$$

wherein h_2 is target height

h_1 is radar or own aircraft altitude

R_S is slant range between own and target aircraft

$\triangle T$ is path length or time difference

The patented device is designed to measure range and time or path length difference and, through the use of these parameters as well as own aircraft altitude, determine target height according to the above relationship. A correction for the earth's curvature can be inserted into the above relationship.

Generally speaking, the patented system includes a transmitter for generating electromagnetic energy pulses, which are conveyed through an amplifier and duplexer to an antenna having a narrow beam in the azimuth or horizontal direction relative to the earth's surface and a wide beam in the elevation or vertical direction. Energy reflected from a target within the radar beam will return via the two paths described above to the antenna.

Appropriate circuitry operates on the return pulses to generate both range and time difference voltages.

The output voltages representing range and time difference are fed to a computer which also receives a voltage corresponding to radar altitude from an altimeter, and target height is computed as a function of these three parameters.

The system also contains elements for indicating target azimuth position and for correcting the target height computation for the earth's curvature.

Validity

Turning now to a consideration of each of defendant's defenses, attention is initially directed to its validity defense.

Claim 1, representative of the breadth of invention claimed, reads as follows:

> 1. A radar device for determining the altitude of a remote object comprising, antenna means, transmitting means for directing electromagnetic energy through said antenna means and toward the remote object, receiving means connecting with said antenna means and being responsive to the electromagnetic energy reflected by the remote object from two energy paths, one path being on a direct line of sight between the antenna means and the remote object and the other path being indirect from the object to the antenna means via a reflection off the surface of the earth, detector means coupled with said receiver means and measuring the time difference in receipt of the energy from the two paths, means responsive to both the transmitted and received energy and providing an output representing the range of the remote object, and means responsive to the output from said detector means and said last mentioned means for determining the height of the remote object.

Prior to plaintiff's invention, and stretching back at least to World War II, it was necessary to utilize a first radar device to search a large sector of space for aircraft and a second radar to determine the height of the aircraft within the sector searched. However, by the use of plaintiff's invention, a single radar is now capable of simultaneously

searching a large sector of space and determining the height of an object within that sector.

The invention includes a height and range finding radar having an antenna through which a transmitter directs electromagnetic energy, a receiver responsive to the electromagnetic energy returning to the radar from a target via direct and ground-reflected paths, a detector for measuring the time difference between receipt by the receiver of the direct and ground-reflected energy, means providing for an output of target range in response to transmitted and received energy, and means determining target height in response to parameters such as target range (Rs) and time difference ($\triangle$T).

The patent specification goes on to emphasize the necessity of own aircraft altitude in carrying out a height computation operation by the following language:

> The $\triangle$T voltage, in combination with a voltage Rs representing the measured range (slant range) of the remote object, and a voltage h_1 representing the altitude of the height finder radar platform 16, provides the necessary information for computing the altitude of the remote object. These three voltage inputs to the computer are operated on to provide a solution * * *.

Defendant contends that the claims in issue are invalid under 35 U.S.C. §§ 102(a),[2] 102(g),[3] and 103. Specifically, it is urged that a paper written by David E. Sunstein on UHF airborne height finding radar is prior public knowledge and anticipates the claimed invention under 35 U.S.C. § 102(a). In addition, defendant argues that work done by Messrs. Leopard and Hair on a Navy project, as well as a lobe counting technique developed at MIT Lincoln Laboratory, are both prior inventions and anticipate individually

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[2] "§ 102. Conditions for patentability; novelty and loss of right to patent.

"A person shall be entitled to a patent unless—

"(a) the invention was known or used by others in this country, or patented or described in a printed publication in this or a foreign country, before the invention thereof by the applicant for patent, or"

[3] "(g) before the applicant's invention thereof the invention was made in this country by another who had not abandoned, suppressed, or concealed it. In determining priority of invention there shall be considered not only the respective dates of conception and reduction to practice of the invention, but also the reasonable diligence of one who was first to conceive and last to reduce to practice, from a time prior to conception by the other."

the claimed invention under 35 U.S.C. § 102(g). Finally, defendant contends that the prior art collectively renders the claimed invention obvious within the meaning of 35 U.S.C. § 103. For reasons which follow, each of these contentions is found to be unsound and accordingly rejected.

The Sunstein paper, which bears a date of November 15, 1954, was a classified document[4] which disclosed a target height finding system based on the three parameters of target range, path length difference and own altitude. Defendant urges that, despite its classified status, the circumstances surrounding and the manner of distribution of the Sunstein paper render it "public" prior knowledge within the meaning of 35 U.S.C. § 102(a). On the other hand, plaintiff argues, *inter alia*, that the Richter invention was conceived prior to the effective date of the Sunstein paper, diligently reduced to practice and that the Sunstein paper accordingly is not a prior art teaching under the statute.

Addressing plaintiff's argument first, it is well established that the burden of proof of an inventor's alleged conception and reduction to practice is a heavy one requiring full corroboration by other than the inventor's own self-serving testimony or records. *Potter Instrument Co.* v. *ODEC Computer Systems, Inc.*, 370 F.Supp. 198, 206, 181 USPQ 572, 577 (D.C. R.I.), *aff'd*, 499 F.2d 209, 182 USPQ 386 (1st Cir. 1974). In fact, this court has held that oral recollections of long past events, unsupported by contemporaneous documentary evidence, are insufficient to meet the strict burden of proof required. *Perry* v. *United States*, 112 Ct.Cl. 1, 76 F.Supp. 503 (1948).

The evidence surrounding the conception and reduction to practice of the Richter height finding invention is fully set forth in the findings. Suffice it to say that the oral testimony of the inventor, Elvin Richter, and the attorney who prepared and prosecuted the Richter patent application, Billy Corber, coupled with the contemporaneous documentary evidence of record, is sufficient to establish

[4] The Sunstein paper was declassified on December 31, 1960, which is long after the March 28, 1955, filing date of the Richter application.

that Richter conceived his height finding invention at least as early as October 28, 1954, and exercised reasonable diligence from that date until the filing of a patent application on the invention on March 28, 1955.

It is therefore concluded that the Sunstein paper of November 15, 1954, is not prior art with respect to the Richter invention.[5] *See In Re Stempel*, 241 F.2d 755, 760, 113 USPQ 77, 81 (CCPA 1957).

Defendant urges next that the work of Messrs. Leopard and Hair anticipates the Richter invention under 35 U.S.C. § 102(g) as a prior invention. This contention is unmeritorious, however, for the simple reason that the radar of Leopard and Hair is a passive range finding radar which is not substantially identical to the structure of the claimed system since, at the very least, it does not have any transmitting circuits. This is a sufficient distinction to dispose of defendant's argument as it is necessary for a teaching, to anticipate an invention under 35 U.S.C. § 102, to show each and every element of the claimed combination. *Tate Engineering, Inc.* v. *United States*, 201 Ct.Cl. 711, 477 F.2d 1336 (1973); *Decca, Ltd.* v. *United States*, 190 Ct.Cl. 454, 420 F.2d 1010, *cert. denied*, 400 U.S. 865 (1970); *Straussler* v. *United States*, 168 Ct.Cl. 852, 339 F.2d 670 (1964).

Defendant's contention fails for the equally persuasive reason that the burden of proof required to establish a prior invention has not been met.[6]

Just as an inventor such as Richter faces a heavy burden in proving his conception and diligence, it is generally recognized that prior invention, use or knowledge, imposes on the party asserting it the requirement of clear and satisfactory proof beyond a reasonable doubt. *Carboline Co.* v. *Mobil Oil Corp.*, 301 F.Supp. 141, 146, 163 USPQ 273, 278

[5] On this basis, it is not necessary to decide whether the Sunstein paper is "public" as 35 U.S.C. § 102(a) has been interpreted to require. It is nevertheless noted that defendant's position regarding the public nature of the Sunstein paper is not supported by precedent. *See, e.g., Simmonds Precision Products, Inc.* v. *United States*, 153 USPQ 465 (Trial Div., Ct.Cl. 1967), 183 Ct.Cl. 969 (1968); *Connecticut Valley Enterprises, Inc.* v. *United States*, 172 Ct.Cl. 468, 348 F.2d 949 (1965).

[6] In this instance although a patent on the Leopard and Hair invention was not filed in the Patent Office until May 19, 1959, defendant nonetheless maintains that the joint invention was conceived on or about October 15, 1953.

(N.D. Ill. 1969); *Meurer Steel Barrel Co.* v. *United States*, 74 Ct.Cl. 428, 13 USPQ 127 (1932), *cert. denied*, 302 U.S. 754 (1937); *The Barbed Wire Patent*, 143 U.S. 275, 284–5 (1892).

Indeed, the oral testimony of witnesses, speaking only from memory in regard to past transactions has, in the absence of contemporaneous documentary or physical evidence, consistently been found to be of little probative value. *Food Machinery Corp.* v. *Pacific Can Co.*, 66 F.Supp. 109, 70 USPQ 474 (N.D. Calif. 1946); *Noma Electric Corp.* v. *M. Goldman & Co.*, 60 F.2d 579, 14 USPQ 88 (D. Conn. 1932). Such uncorroborated testimony is insufficient to show anticipation, within the meaning of 35 U.S.C. § 102, of an issued patent. *Montgomery* v. *United States*, 65 Ct.Cl. 526 (1928).

In the present case, the evidence of record consists of the testimony of the two inventors and one of their co-workers, William McMurran, all employees of defendant. Further, the documentary evidence consists largely of hearsay, recorded 5 to 6 years after the alleged events.

The uncorroborated testimony of prior inventors or users should be evaluated with particular caution, *see Carboline*, *supra*, 301 F.Supp. at 146–48, as should the oral testimony of an employee of a party to the litigation, recollecting events long past. *Aqua-Chem, Inc.* v. *Baldwin-Lima-Hamilton Corp.*, 167 USPQ 257, 267 (N.D. Ill. 1970), and cases cited therein.

Under these circumstances, it is concluded that the invention of Leopard and Hair, even assuming, *arguendo*, the presence therein of all the structural elements found in the Richter claims, has not been satisfactorily proven to have been conceived prior to Richter's conception and constructive reduction to practice.

Turning now to the question of obviousness under 35 U.S.C. § 103, it is hornbook law that the claims measure the invention and a resolution of the obviousness of an invention must be based on what is claimed. *Douglas* v. *United States*, 206 Ct.Cl. 96, 510 F.2d 364, 423 U.S. 825 (1975). In determining the obviousness or nonobviousness of an invention, the scope and content of the prior art is to be determined, the differences between the claims and the prior art are to be ascertained and the level of ordinary

skill in the pertinent art is to be resolved. *Graham* v. *John Deere Co.*, 383 U.S. 1, 17 (1966).

It was known in the prior art, prior to the conception of the Richter invention, that an electromagnetic wave or pulse signal transmitted from a radar device would reflect off an object within its path and return to the radar. Distance, or range, from the radar to the object was conventionally measured by observing the time lapse between transmission and receipt of the return signal.

The use of particular receivers for reception of the return signals was also well known. For example, it was known that since the bandwidth of a receiver is inversely proportional to its response time, a wide band receiver, one that accepts a wide band of frequencies, has a short period of response and faithfully reproduces the shape of a signal. However, the signal to noise ratio of such a receiver is poor and noise level equals signal level. Conversely, a narrow band receiver, which accepts only selective frequencies, provides a distorted signal shape but has a reduced noise level and thus increases range capability since weaker signals can be detected in the reduced noise level. When receiver bandwidth and transmitter frequency are matched, *i.e.*, when bandwidth is the reciprocal of transmitted signal wavelength, the signal to noise ratio is optimized.

It was also known that radar signals are transmitted, by way of an appropriate antenna, to an object by at least two paths, one directly to the object and another indirectly from the radar to the earth's surface to the object.

In fact, German Patent No. 672,303 which issued to Mr. Hans Schuchmann, on March 1, 1939, shows a passive system for determining the range of an object by measuring at a receiving aircraft the time difference between receipt of the direct and ground-reflected signals transmitted from the object. Range is computed according to the same intrinsic relationship used by Richter. Schuchmann's system utilized an oscilloscope to measure time difference but depended upon a knowledge of the altitude of the target aircraft as well as the receiving aircraft. The system was thus ineffective for determining the range of truly unknown aircraft.

The range equation utilized by Schuchmann is based upon the geometry of two aircraft in relation to the earth's surface and defines the mathematical relationship between target height, own height, target range and time or path length difference.

The time difference between the receipt of the direct and indirect signals, in the Schuchmann system, is a function of the path length difference and the speed of propagation of the signals. Since the indirect signal travels a farther distance than the direct signal, it will arrive at the receiving station a short time after the direct signal.

The work of Mr. Robert H. Dicke must also of necessity be considered and mentioned in any realistic attempt to evaluate the state of the art at the time of the Richter invention. Mr. Dicke was concerned with being able to understand and decipher the response received when two objects are within the same radar beam, since the return signals may in such a situation be received as overlapping signals. As a result, Mr. Dicke developed a system for separating overlapping signals to enable a better analysis of the return signals and improve the accuracy of the system's results. In operation, the Dicke system modulates the transmitted radar signals of a conventional radar and subjects the return signals to pulse compression, and, as a result, long duration overlapping pulses are separated into short duration distinct signals. United States Letters Patent No. 2,624,876 was granted to Dicke on January 6, 1953.

Another prior art radar system relevant to a 35 U.S.C. § 103 analysis is described by United Kingdom Patent No. 588,763, issued June 3, 1947, to Mr. Otto M. Bohm. Mr. Bohm developed a system for measuring target height, known as the signal comparison system, which utilized the same geometric relation as Richter's invention, but in terms of target range and angle of elevation between two aircraft. The angle of elevation is functionally related to the time difference between receipt of direct and ground-reflected signals. Range was measured by conventional radar equipment. Bohm determined that radar receivers mounted at different heights exhibited varying field strengths upon receipt of radar pulse return signals, the

ratio of which equaled angle of elevation. Using target range and angle of elevation, target height could be calculated. The Bohm patent was considered by the Patent Office examiner during his evaluation of the Richter application.

The signal comparison system of Bohm was acknowledged by Louis N. Ridenour in his book on radar systems, published in 1947.[7] The Ridenour text also disclosed a second method of height finding termed null counting, or lobe counting as it was later known.

In the lobe counting method, when a radar beam reflects energy off the ground, a secondary elevation lobe pattern of maxima and minima energy lobes is produced, as shown, for example, in finding 34.

As explained in the Ridenour text, if the lobe pattern is known, the height of the target can be estimated from the range of first appearance of a target in the lobe pattern. This system has inherent drawbacks which detract from its accuracy, as fully enumerated in finding 35.

This was the state of the pertinent prior art when Richter developed his height finding radar in late 1954.[8]

The individual elements, *i.e.*, the various electronic circuits, cathode ray tubes, etc., from which Richter developed his height finding and search radar were well known at the time of his invention, as is the case in virtually all inventions involving a combination of elements. The claims of the patent define an overall combination of elements to determine range and target height and it is this combination which must be viewed as a whole in arriving at a determination as to the patentability of the claimed subject matter. *See Tate Engineering, Inc.* v. *United States*, 166 USPQ 329, 335 (Trial Div. Ct.Cl.), 193 Ct. Cl. 1088 (1970).

A comparison of the claimed combination and the prior art reveals several basic differences, fundamental to which

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[7] RADAR SYSTEM ENGINEERING, McGraw Hill Book Co., 1947.

[8] Richter conceived his invention at least as early as October 28, 1954, as fully explained *supra*. Thus, the Sunstein paper, dated November 15, 1954, and a patent to Lester D. Van Valkenburgh, U.S. Patent No. 2,837,738, described in findings 22–25, even if it be accorded a date of conception of February 9, 1955, as urged by defendant, are not part of the pertinent prior art with respect to the Richter invention.

is the concept of using means in combination with a conventional range radar system for the direct measurement of time difference between receipt of direct and ground-reflected radar signal pulse echoes from a target for use in calculating target height. It is concluded that this difference alone renders the claims valid.

Theoretically, the relationship between target range, target height, radar height and time difference was known in the art years prior to the Richter invention. Indeed many of the prior art systems were based on this geometrical relationship. It is concluded, however, that the prior art in no way suggests, either expressly or impliedly, the use of a direct measurement of time difference between direct and ground-reflected signal echoes in combination with a conventional radar range system for additionally determining target height. A combination of old elements to produce a new and useful result is patentable. *Saulnier* v. *United States*, 148 Ct.Cl. 507, 180 F.Supp. 412, *cert. denied*, 363 U.S. 829 (1960); *Zonolite Co.* v. *United States*, 138 Ct.Cl. 114, 149 F.Supp. 953 (1957); *Badowski* v. *United States*, 135 Ct.Cl. 93, 140 F.Supp. 544 (1956).

Several factors compel this conclusion. Prior to the Richter invention, MIT's Lincoln Laboratory was conducting classified studies on behalf of the United States into the feasibility of lobe counting as a height finding method. Several reports, declassified subsequent to the issuance of the Richter patent, disclose the nature of the lobe counting technique, explained in detail by defendant's expert, Jerome Freedman.

It is clear that these reports, classified at the time the Richter patent issued, are not prior art within the meaning of 35 U.S.C. §§ 102 or 103. *Stamicarbon, N.V.* v. *Escambia Chemical Corp.*, 300 F.Supp. 1209, 1215, 160 USPQ 815, 821 (N.D. Fla. 1969), *Aff'd*, 430 F.2d 920 (5th Cir. 1970), *cert. denied*, 400 U.S. 944; *Carboline, supra; Minneapolis-Honeywell Regulator Co.* v. *Midwestern Instruments, Inc.*, 298 F.2d 36, 38, 131 USPQ 402, 404 (7th Cir. 1961).

Nevertheless, such classified reports are indicative of the general level of skill in the art. *Del Mar Engineering Lab.* v. *United States*, 207 Ct.Cl. 815, 524 F.2d 1178 (1975); *Simmonds Precision Products, Inc.* v. *United States*, 153

USPQ 465, 468 (Trial Div., Ct.Cl. 1967), 183 Ct.Cl. 969 (1968); *Servo Corp. of America* v. *General Electric Co.*, 337 F.2d 716, 720, 143 USPQ 85, 88 (4th Cir. 1964), *cert. denied*, 383 U.S. 934 (1966).

In the lobe counting technique developed by MIT there is a unique rate of lobes per mile which a target will traverse as a function of any given target range and height. A lobe is the term used to identify each finger-like maxima in the elevation lobe pattern. Choosing a radar height, graphs representing lobes per mile versus target range were computed at Lincoln Lab for various known target heights and ranges, thus yielding graphs showing a family of target height curves. *See* finding 36. Having computed these graphs for selected target heights and ranges, the target height of an unknown object could then be estimated by observing the number of lobes per mile traversed by a target on an oscilloscope, measuring the target range and then finding the target height from the graphs as the point of intersection of the observed coordinates.

The accuracy of the computed graphs was tested at Lincoln Lab using a newly-developed UHF AEW radar. While the theoretical derivation of the lobe counting graphs involved the rate of change of time difference, it does not utilize a time difference measurement in its calculation. Moreover, the newly-developed radar hardware at Lincc. . Lab amounted to no more than an obvious combination of electronic equipment, as conceded by defendant.[9]

Thus, at the time Richter conceived his invention, highly trained radar personnel at MIT's Lincoln Laboratory were using a conventional radar in conjunction with graphs which had been laboriously and tediously produced over a period of several months to establish the height of target aircraft. Where, as in the instant case, it is shown that the idea of the invention was not apparent to persons who were

[9] Since lobe counting utilized prior art hardware in a conventional and well-known manner, it does not disclose plaintiff's patented combination and thus defendant's contention that the MIT Lincoln Lab lobe counting anticipates the Richter claims as prior invention under 35 U.S.C. § 102(g) is unmeritorious. *Straussler* v. *United States*, 168 Ct.Cl. 852, 339 F.2d 670 (1964). This assumes, *arguendo*, that such classified material can form the basis of a § 102(g) prior invention. *See Del Mar Engineering Lab.* v. *United States*, 207 Ct.Cl. 815, 524 F.2d 1178 (1975).

trained and skilled in the particular art to which it relates, and familiar with the type of apparatus which the invention involves, it may be concluded that Richter's invention was not obvious to the ordinary man skilled in the art. *Olsson* v. *United States*, 72 Ct.Cl. 72 (1931).

Further evidencing the unobviousness of Richter's height finding radar is the long-felt need for a combined search and height finding radar, dating at least as far back as the Second World War, and the failure of others to provide a satisfactory solution. *Blumcraft of Pittsburgh* v. *United States*, 178 Ct.Cl. 798, 372 F.2d 1014 (1967); *Graham* v. *John Deere Co.*, *supra*.

It is therefore concluded that claims 1, 2, 4, 5 and 7 to 10, the claims in issue, are valid.

Infringement

The accused device is the AN/APS–96 radar set used by the Navy in its Model E–2A Hawkeye aircraft. Briefly, the accused device is characterized by a coherent master oscillator that generates fixed-frequency electromagnetic pulses which, after pulse expansion, frequency conversion, amplification and modulation, are radiated into space by a highly directional antenna having a wide elevation beam and a narrow azimuth beam. The device has receiving circuits for reception of return pulses from a target object which include pulse compression circuits, as described in the findings, for separation of the direct and ground-reflected return pulses.

An association control and range accumulator are responsive to the transmitting and receiving circuits so as to detect target range while a height counter detects time difference in response to the direct and ground-reflected return pulses. Time difference and target range are fed as digital signals to a digital computer, along with a signal representative of own aircraft altitude, and the computer calculates target height, which is suitably displayed for use by a computer indicator group. The accused device operates automatically and requires no manual operations.

In determining the question of infringement, it has long been established that the claims of a patent define the

metes and bounds of an invention and must be looked to in determining if there has been infringement. *Strumskis* v. *United States*, 200 Ct.Cl. 668, 474 F.2d 623, *cert. denied*, 414 U.S. 1067 (1973); *Badowski* v. *United States*, 143 Ct.Cl. 23, 27, 164 F.Supp. 252, 255 (1958). However, the scope and breadth of the claimed subject matter must necessarily be established before the question of infringement can be resolved. *Tate Engineering, Inc.* v. *United States*, 201 Ct.Cl. 711, 477 F.2d 1336 (1973).

It is a corollary of the above that while the specification and drawings of a patent may lend aid in interpreting the claims, *Autogiro Co. of America* v. *United States*, 181 Ct.Cl. 55, 384 F.2d 391 (1967), *rehearing denied*, 184 Ct.Cl. 801 (1968), the claims of a patent are not limited in scope to the best mode for practicing the invention or to any particular mode for practicing the invention that is described in the specification or drawings. *National Dairy Products Corp.* v. *Swiss Colony, Inc.*, 176 USPQ 405, 419 (W.D. Wis. 1972). With these guidelines in mind, and having considered the file history of the Richter patent application as well as the evidence presented at trial that was not before the Patent Office, it is concluded that the claims of the Richter patent should not be construed within a narrow compass but, rather, should be accorded a broad and liberal interpretation so as to cover a reasonable range of equivalent devices performing substantially the same work in substantially the same manner to achieve substantially the same results as the claimed system read in light of the disclosed modes.

Other factors dictate such a conclusion. Defendant's expert witness considered the MIT lobe counting work to be the closest teaching to the patented invention. Yet, this work reveals a height finding system utilizing a conventional combination of electronic elements at the time Richter developed his height finding system. Such an approach was developed by trained personnel at MIT Lincoln Lab as a solution to the longstanding need for a single radar capable of both search and height finding functions. A patent should be accorded a liberal interpretation where it discloses not just an improvement in existing equipment, but rather a different route yielding a basic solution to a long-existing problem. *Maschinenfabrik Rieter*

A.G. v. *Greenwood Mills*, 340 F.Supp. 1103, 173 USPQ 605 (D.C. S.C. 1972).

Having determined that the claims in issue are entitled to a broad range of equivalents, the claims must next be read upon the accused device. As fully set forth in the findings, using claim 1 as a representative claim, it is clear that claim 1 literally reads on the accused device. The inquiry continues, however, for the accused device must additionally be shown to substantively infringe the claims by performing the same work, in substantially the same manner to achieve substantially the same result as the claimed device. *Autogiro, supra*, 181 Ct. Cl. at 67, 384 F.2d at 400.

Defendant points to the following four structural distinctions between the claimed and accused devices as conclusive proof of their nonequivalency:

1. the use of two separate receivers in the claimed device, specifically, a broad band receiver for time or path length difference and a narrow band matched receiver for range, versus the use of a single receiver with pulse compression filters in the accused device;
2. the use of a fixed-frequency electromagnetic pulse in the claimed device versus the use of frequency-modulated pulses in the accused device;
3. the manual detection of time or path length difference after receipt in the claimed device versus the automatic detection thereof in the accused device; and
4. means responsive to range and time difference for determining target height in the claimed device (claims 1, 2, 8, 9, 10) versus means responsive to range, time difference and own altitude for determining target height in the accused device.

It is concluded, for reasons which follow, and as more fully set forth in the findings of fact, that, despite these contentions, the accused device infringes the invention claimed.

Each of defendant's contentions will now be fully considered with attention being initially directed to its fourth asserted distinction.

Claim 1 recites, in pertinent part:

* * * means responsive to the output from said detector means [time difference output] and said last mentioned

means [range output] for determining the height of the remote object.

First, it should be pointed out that the clause is not of closed construction. It does not recite means responsive *only* or *solely* to range and time difference outputs, but merely expressly requires at least those two factors. The clause thus covers or embraces an element such as the height coordinate computer of the accused device, which responds to range, time difference and own altitude for height computation.

However, more to the point, the Supreme Court in *Motion Picture Patents Co.* v. *Universal Film Mfg. Co.*, 243 U.S. 502, 510 (1917), stated that:

> The scope of every patent is limited to the invention described in the claims contained in it, read in the light of the specification.

This guideline was recently repeated by the Supreme Court in *United States* v. *Adams*, 383 U.S. 39, 49, 148 USPQ 479, 482 (1966), when it announced:

> * * * it is fundamental that claims are to be construed in the light of the specifications and both are to be read with a view to ascertaining the invention, * * *.

The above clause comprising as it does a means plus a statement of function, is governed by 35 U.S.C. §112, para. 3. That paragraph provides:

> An element in a claim for a combination may be expressed as a means or step for performing a specified function without the recital of structure, material, or acts in support thereof and such claim shall be construed to cover the corresponding structure, material, or acts described in the specifications and equivalents thereof.

While it is thus essential in clauses which utilize "means" clauses to look to the specification to establish the structure covered thereby, it is also imperative that para. 2 of 35 U.S.C. § 112,[10] which requires that the claims of a

[10] "§ 112. Specification.

* * * * *

"The specification shall conclude with one or more claims particularly pointing out and distinctly claiming the subject matter which the applicant regards as his invention. A claim may be written in independent or dependent form, and if in dependent form, it shall be construed to include all the limitations of the claim

patent particularly point out and distinctly claim the subject matter that the applicant regards as his invention, not be totally ignored.

When faced with exactly the same question, the court in *Technitrol, Inc.* v. *Control Data Corp., et al.*, 394 F.Supp. 511, 185 USPQ 801 (D.C. Md. 1975), correctly concluded that a "means plus function" claim covers the structure necessary to perform the specified function.

Accordingly, it is fitting and proper to look to the specification in interpreting the claims of the patent in suit and this is so even if such a review results in a narrower interpretation of the claims than the broad means plus function clauses of the claims would at first indicate. *Roberts Dairy Co.* v. *United States*, 208 Ct.Cl. 830, 530 F.2d 1342 (1976).

In the present case, defendant argues that the above-quoted language of claim 1 indicates that range and time difference voltages are the *only* inputs required by a computer to calculate the height of the remote object. However, a careful review of the specification and drawings of the patent clearly indicates that additional inputs are necessary for the computer to make the desired target height calculation. Specifically, Fig. 1 of the drawings shows that an altimeter 51 supplies the required altitude of the radar carrying aircraft to the computer shown schematically by block 3.

Moreover, in describing the Fig. 1 schematic, the patentee states:

> Referring to FIGURE 1 it is seen that the height finding radar device of this invention includes a basic radio detection and ranging unit 1, a delta range detection unit 2, an altimeter 51 and a computer 3. The computer is responsive to the delta range detection unit 2, the basic radar unit 1 and the altimeter device 51 for computing the altitude of a remote object located within the search field of the radar device.[11]

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incorporated by reference into the dependent claim."

[11] See bridging paragraph beginning at line 16, col. 2, and terminating at line 2 of col. 3.

Further evidence of the necessity of own aircraft altitude in making the height calculations of a target aircraft is found at lines 5 to 11 of col. 7, whereat is found:

> The $\triangle T$ voltage, in combination with a voltage Rs representing the measured range (slant range) of the remote object, and a voltage h_1 representing the altitude of the height finder radar platform 16, provides the necessary information for computing the altitude of the remote object. These three voltage inputs to the computer are operated on to provide a solution to the following equation:
>
> $$h_2 \cong \frac{\triangle TR_S}{2h_1}$$

Thus it is clear that the computer 3 of Fig. 1 requires the presence of voltage inputs representing range, time difference and own aircraft altitude before it can solve the basic equation that defines the height of the target aircraft.

As a result of these statements in the specification and the disclosure shown in Fig. 1 of the drawings, and in the interest of determining the true meaning of the claims, it is concluded that the height determining means of the claims of the patent in suit require at the very least inputs of range, time difference and own aircraft altitude. *See Autogiro, supra,* 181 Ct. Cl. at 63–4, 384 F.2d at 397–8, where this court indicated that the specification needs to be looked to as the concordance for the claims.

Accordingly, defendant's noninfringement argument based on its fourth structural distinction between the accused device and the claimed invention must be rejected.

With respect to the second and third differences, claim 1 recites, in pertinent part:

> * * * transmitting means for directing electromagnetic energy through said antenna means and toward the remote object, * * *
> * * * detector means coupled with said receiver means and measuring the time difference in receipt of the energy from the two paths, * * *.

The transmitting means is not limited to fixed or modulated frequency and the detector means is not limited to manual or automatic detection. Further, looking to the

specification, it is clear that both fixed and modulated frequency,[12] as well as manual or automatic detection,[13] are specifically disclosed alternatives and equivalents. In sum, the differences listed above are, in fact, not differences at all, as the specification clearly contemplates either form. Provision in the accused device for frequency modulation and automatic detection thus does not avoid infringement.

Finally, addressing defendant's first alleged distinction, it should be noted that claim 1 recites in pertinent part:

> * * * receiving means connecting with said antenna means and being responsive to the electromagnetic energy reflected by the remote object from two energy paths, one path being on a direct line of sight between the antenna means and the remote object and the other path being indirect from the object to the antenna means via a reflection off the surface of the earth, * * * * * * means responsive to both the transmitted and received energy and providing an output representing the range of the remote object, * * *.

These elements are recited in "means plus function" terminology, and, as explained hereinabove, where a claim sets forth a means for performing a specific function, without reciting any specific structure for performing that function, the structure disclosed in the specification must be considered, and the patent claim construed to cover both the disclosed structure and equivalents thereof. The receiving means of claim 1 corresponds with the broad band height finding receiver illustrated in the specification while the range means corresponds with conventional radar range equipment set forth in the specification. Thus claim 1 defines a system including these specifically disclosed elements and equivalents thereof.

To establish infringement, it is next necessary to consider whether the use of pulse compression, which requires frequency modulation, is the equivalent of Richter's use of a broad band height finding receiver and a range detection receiver.

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[12] See lines 30–3 of col. 8 of the patent in suit.
[13] Col. 8, lines 67–74; col. 9, lines 58–63.

As more explicitly set forth in the findings, the pulse compression circuits of the accused device and the broad band height finding receiver exemplified in the Richter patent function in substantially the same manner to achieve substantially the same result within the context of the height finding radar. Specifically, both elements effectively process the return pulses for generating an output representative of the time difference in receipt of the first two return pulses. While the particular mechanism of the two elements has distinguishing features, these are not such as to vitiate the equivalency of their functioning within the overall combination.

It has often been said that a useful guide in adjudging the equivalency between a claimed and an accused device is whether persons reasonably skilled in the art would have known of the interchangeability of a part in the accused device with one in the claimed device. *Jamesbury Corp.* v. *United States*, 153 USPQ 672, 207 Ct. Cl. 516, 518 F.2d 1384 (1975); *Graver Tank & Mfg. Co.* v. *Linde Air Products Co.*, 339 U.S. 605 (1950), or would have treated elements or parts as equivalents. *Tektronix, Inc.* v. *United States*, 195 Ct.Cl. 53, 445 F.2d 323 (1971).

Stated otherwise, equivalency is established where a person reasonably skilled in the art would have known of the interchangeability of an ingredient not disclosed in the patent with one that was. *Adams* v. *United States*, 165 Ct.Cl. 576, 330 F.2d 622 (1964), *aff'd*, 383 U.S. 39 (1966).

This is particularly apropos to the facts of this case, where the expert witnesses of both parties have indicated that theoretically it would have been obvious to one of ordinary skill in the art, at the time Richter developed his invention, to use pulse compression and frequency modulation as a substitute for the fixed frequency and broad band height finding receiver illustrated by Richter in his specification.

Defendant argues against equivalency by pointing out that, in practical operation, the broad band receiver is an effective height finding receiver out to a range of about 70 miles whereas pulse compression allows effective height finding as far out as 180 miles. This is a variance to note, but it is nevertheless universally accepted that infringe-

ment is not avoided simply because an accused device constitutes an improvement of the claimed invention. *Cardinal of Adrian, Inc.* v. *Peerless Wood Products, Inc.*, 363 F.Supp. 1298, 179 USPQ 527 (E.D. Mich. 1973); *Amerace Esna Corp.* v. *Highway Safety Devices, Inc.*, 330 F.Supp. 313, 171 USPQ 186 (N.D. Tex. 1971); *Edoco Technical Products, Inc.* v. *Peter Kiewit Sons' Co.*, 313 F.Supp. 1081, 165 USPQ 207 (C.D. Calif. 1970); and *Eastern Rotorcraft Corp.* v. *United States*, 184 Ct.Cl. 709, 397 F.2d 978 (1968).

Particularly convincing in the present case is the fact that the concept of pulse compression for separation of overlapping pulses was well known in the prior art before the development of Richter's invention. This is shown by reference to the Dicke patent which issued on January 6, 1953, long before the October 28, 1954, conception date of Richter. Equivalency may be shown by the prior art. *Tate, supra*, 201 Ct.Cl. at 727, 477 F.2d at 1345; *American Technical Machine Corp.* v. *Caparotta*, 339 F.2d 557, 144 USPQ 115, 117 (2d Cir. 1964), *cert. denied*, 382 U.S. 842 (1965). Thus, the "improved equivalent," *i.e.*, pulse compression, was available to those of ordinary skill in the art for use of Richter's invention when developed.

Defendant argues further that no one in the radar art was familiar with or even knew about pulse compression in 1954. Indeed, it appears that the radar personnel at Lincoln Lab were unfamiliar with pulse compression. Richter, while he had heard about it, was likewise unfamiliar with the concept. Regardless, prior art is prior art, and is presumptively known to the hypothetical man skilled in the art, even though its teachings are not generally known in the industry to which it relates. *See, e.g., Texas Co.* v. *Globe Oil & Refining Co.*, 112 F.Supp. 455, 493, 98 USPQ 312, 342 (N.D. Ill., 1953), *aff'd*, 225 F.2d 725, 106 USPQ 392 (7th Cir. 1955).

Finally, defendant argues that, since Richter knew about pulse compression in 1954, but did not incorporate it expressly into his invention and never discussed it with his attorney for incorporation into the patent application, nonequivalency can be concluded.

Defendant's position is overstated. When asked about pulse compression at trial, Richter responded:

> No. I had heard of pulse compression. It was a subject that was faintly moving around in the industry. People were working on it. I was not personally familiar with it; I just knew that it was a thing that would some day come along because people were working on it.

It is, of course, fundamental that a patentee need disclose only the best mode conceived by him for practicing the invention, not all conceivable modes. *Jack Winter, Inc.* v. *Koratron Co.*, 375 F.Supp. 1, 181 USPQ 353 (N.D. Calif. 1974). To require otherwise would place an unreasonable burden on the patentee, a burden not required by 35 U.S.C. § 112. Richter was not "personally familiar" with pulse compression in 1954 and the patent in suit appropriately reflects what he conceived to be the best mode at that time. This does not vitiate equivalency. It has long been settled that infringement is not avoided by an equivalent that was not known at the time of the invention. WALKER ON PATENTS, § 415 (1917 and 1929 eds.); *Diamond Int'l. Corp.* v. *Maryland Fresh Eggs, Inc.*, 374 F.Supp. 1223, 182 USPQ 147 (D.C. Md. 1974); *Waterproof Insulation Corp.* v. *Insulating Concrete Corp.*, 153 F.Supp. 626, 114 USPQ 265 (D.C. Md. 1957).

In view of the above, it is concluded that claim 1 reads literally and substantively on the use of pulse compression for time difference measurements.

Continuing, the use of two matched receivers versus a single matched receiver as in the accused device is clearly seen to be equivalent since it becomes merely a matter of preference as to whether the return pulses are received by a single matched receiver and then separately processed for range and time difference detection (as in the accused devices) or received by two separate receivers (a range receiver and a broad band receiver) and separately processed. Ultimately, after initial reception, the two systems both derive range and time difference separately. The use of a single means to perform the same function in the same manner as two separate means does not avoid infringement. *Blohm & Voss AG* v. *Prudential-Grace Lines, Inc.*, 346 F.Supp. 1116, 174 USPQ 484 (D.C. Md. 1972), *rev.*

on other grounds, 489 F.2d 231 (1973); *Apex Electrical Mfg. Co.* v. *Maytag Co.*, 122 F.2d 182, 50 USPQ 90 (7th Cir. 1941), *cert. denied*, 314 U.S. 687.

In sum, plaintiff has established infringement of claims 1, 2, 4, 5 and 8 to 10 of the Richter patent by the accused Navy radar AN/APS–96.[14]

License

In addition to the defense of noninfringement, defendant also contends that it has acquired a royalty-free license to use the invention described in the Richter patent. Attention is now directed to defendant's contention of being licensed under the patent in suit as a result of certain provisions in Navy contract NOas–52–1041–c (hereinafter the 1041–c contract) between Lockheed and the Department of the Navy, and certain amendments made thereto. To address defendant's proposition first requires a short history of the evolution of the 1041–c contract.

During the early '50s, the Navy's WV–2 aircraft had an AN/APS–45 height finding radar mounted in a radome on top of the fuselage and an AN/APS–20B search radar mounted in a radome under the fuselage. Lockheed entered into the 1041–c contract with the Department of the Navy on June 28, 1952, for the primary purpose of solving an existing problem of ice accumulation on the upper and lower radomes, as well as on the nose of the aircraft, since such accumulation had an adverse effect on radar performance.

Over the next two years, work proceeded under the 1041–c contract, which was amended several times, on the design, development, ground and flight testing of de-icing provisions for the WV–2 aircraft. By mid-July of 1954, Lockheed had submitted a summary report of its work to the Bureau of Aeronautics (hereinafter BUAER).

Meanwhile, Lincoln Laboratory was conducting Project Lincoln, which included the development of a UHF search

[14] As explained fully in finding 85, claim 7 specifically recites that the transmitted pulses are fixed frequency and the ΔT receiver is a broad band receiver. Since neither of these elements are found in the AN/APS–96, claim 7 of the Richter patent is not infringed thereby. A claim-by-claim infringement analysis of the remaining claims 1, 2, 4, 5 and 8 to 10 can be found in the findings of fact.

radar to be eventually used on the WV–2 aircraft. Lockheed was aware of this project and, by conference letter of April 7, 1954, to BUAER, proposed a six-phase research and development program for a radome-antenna assembly to be used for mounting the UHF search radar on top of the WV–2. Briefly stated, phase I of the proposal consisted of the preliminary design studies and wind tunnel investigations; phase II involved preparation of plans and drawings for manufacturing a prototype radome; phase III involved the actual manufacture and installation of the prototype radome in an aircraft; phase IV concerned the installation of prototype electronic equipment from Lincoln Lab, as well as the design, development and installation of an antenna; phase V involved the design and development of the aircraft radar system; and phase VI covered the design for production of a DEW aircraft resulting from the work achieved in phases I to V. Plaintiff requested that this program be adopted by amending the 1041–c contract.

At the request of BUAER the April 7, 1954, proposal was replaced by subsequent letter, dated July 19, 1954, of the same general nature as the earlier proposal. The July 19, 1954, proposal provided in pertinent part as follows:

Phase I:

> This phase is essentially complete relative to DEW/CIC design and consists of the following:
> Preliminary Design studies investigating airplane performance with various aero-dynamic configurations.
> Military Operations Research evaluation of each antenna radome configuration as to probability of detection with varying targets and studies of operational altitudes, speeds, etc., of the search airplane.
> Wind Tunnel model investigations of the likely Preliminary Design configurations utilizing these data to develop the final configuration and performance.
> Making additional wind tunnel tests of these final configurations including the effects of power.
>
> * * * * *

Phase V:

> This phase consists of the design and development of the airplane's radar system including operator's con-

soles, inter-communication systems, video distribution system, etc. The height finder capabilities of the antenna-radome combination will be included in this phase. In order to more efficiently realize maximum compatability of the airplane and the proposed operational concept, the Contractor requests the opportunity to assume responsibility for the radar system design requirements.

Both radar height finding and searching functions were operational requirements of the WV–2 aircraft. Thus the incorporation of a top-mounted UHF search radar on the WV–2 presented potential compatibility problems with the already top-mounted AN/APS–45 height finding radar.

At the time of the proposal the parties do not appear to have settled upon any particular structural design to solve the compatibility problems. Thus the work under phase I could have included consideration and design of either two radomes to house the height finding and search radars or a single radome to perform the same task. In addition, phase V appears to have left open the option of plaintiff's designing a new radar system to achieve the height finding and search functions that were then being performed by the AN/APS–45 and AN/APS–20B radars.

Paragraph 6 of plaintiff's July 19, 1954, proposal evidences Lockheed's awareness of these compatibility considerations. However, this paragraph also reveals that Lockheed had developed a radome configuration "* * * which permits installation of the presently available APS–45 height finding equipment with its antenna mounted in the radome support pedestal." It thus appears that Lockheed had at least initially felt it could solve the compatibility problems by designing a configuration for mounting both the UHF search radar and the AN/APS–45 height-finding radar on top of the WV–2 fuselage. This design afforded equivalent height finding capability to the then-existing WV–2 design.

Lockheed, by way of the proposal, also indicated that future radar development would most likely provide UHF height finding compatible with the Project Lincoln UHF search radar and that the resulting two radar systems would increase surveillance capability. Thus the AN/APS–45 was proposed as an interim configuration "* * * until

the probable development suggested above [the hoped-for new UHF height finding radar] can afford height finding capability compatible with the range capability of the new Project Lincoln UHF search radar."

As a result of further negotiations with BUAER, the phase I proposal was modified by Lockheed in a conference letter dated August 27, 1954, as follows:

> A. Design studies to include capability for CIC with APS–45 as interim configuration. Evaluate effect of Fore and Aft location and Vertical Height in regard to basic performance of the airplane.

"CIC" is an acronym for combat information center for housing the electronic equipment, such as radar, for deriving its own, as well as target aircraft information.

It thus appears that the parties had decided that the AN/APS–45 should be used as an interim height finding radar and Lockheed proposed that the contract be modified additionally to include a study of the operation and performance of the AN/APS–45 vis-a-vis the radome antenna configurations it had evolved.

Amendment 7 to the 1041–c contract was executed in August 1955 and reflected the negotiations between the parties. This amendment provided, by way of phase I, for a continuing research, development and test program for an AEW/CIC/DEW aircraft. Phase I in pertinent part reads as follows:

> (a) The Contractor shall conduct preliminary design studies and military operations research evaluations of various radome-antenna configurations of AEW-/CIC/DEW aircraft, including all pertinent independent and related aspects of radar and airplane performance, and including design and operations considerations for APS–45 Height Finding.

This work was to be performed in conformance with the July 19 and August 27, 1954, Lockheed proposal letters.

A careful review of the evidence of record amply demonstrates that over the years, and as late as December 1956, both plaintiff and defendant were content in continuing with their initial plan of incorporating both an

AN/APS–70 search radar[15] and an AN/APS–45 height finding radar on top of the WV–2 aircraft.

Subsequently, in February of 1957, amendment 14 to the 1041–c contract, over which the parties focus their argument, was adopted, subject to the same July 19 and August 27 proposals, and provided in pertinent part as follows:

> Conduct a design study program and wind tunnel investigation of the AEW/CIC/DEW aircraft. Modify one (1) Government Furnished WV–2 airplane into a rotadome airplane. Install radar equipment to make an operational electronic evaluation airplane and conduct tests.

The scope of work outlined by amendment 14 which appears below is identical to that of amendment 7, which it replaced:

> (a) The Contractor shall conduct preliminary design studies and military operations research evaluations of various radome-antenna configurations of AEW-/CIC/DEW aircraft, including all pertinent independent and related aspects of radar and airplane performance, and including design and operations considerations for APS–45 Height Finding.

Amendment 14 also contained a retroactive costs provision as follows:

> 11. Costs not in excess of $3,726,179.00, incurred subsequent to 1 April 1954 and prior to 1 February 1957, and which if incurred subsequent to the date of this amendment, would have been considered as allowable costs hereunder, shall be considered as allowable costs.

A contemporaneous interpretation of the scope of work authorized by amendment 14 is provided by a procurement analyst's March 21, 1957, statement, which provided in pertinent part:

> 2. Under Contract NOas 52–1041–c as amended, Lockheed Aircraft Corporation has been conducting a research and development program to modify a WV–2 aircraft to meet CNO Confidential operational requirement NOad–06502 as a non-carrier based AEW aircraft for improved and unrestricted tactical AEW warfare. The proposed procurement represents an increase in

[15] The AN/APS–70 search radar was a UHF radar which replaced the AN/APS–20B.

scope under the aforesaid contract, the purpose of which is to determine the radiation patterns of the AN/APS–45 and the AN/APS–70 radar antennas when installed in their radomes on top of the WV–2E fuselage. It is deemed essential and expedient to determine the effects of aircraft fuselage and radomes on the radiation patterns to assure that the radar system of the WV–2E aircraft will be at optimum performance in order that the production version of the aircraft will be capable of performing its planned operational mission.

In addition to the above provisions and amendments, the original 1041–c contract contained the following patent rights clause in *para. 36:*

(a) As used in this clause, the following terms shall have the meanings set forth below:
(i) The term "Subject Invention" means any invention, improvement or discovery (whether or not patentable) conceived or first actually reduced to practice either (A) in the performance of the experimental, developmental or research work called for under this contract * * *.

* * * * *

(b) The Contractor agrees to and does hereby grant to the Government an irrevocable, nonexclusive, nontransferable, and royalty-free license to practice, and cause to be practiced for the Government throughout the world, each Subject Invention in the manufacture, use, and disposition according to law, of any article or material, and in the use of any method * * *. Nothing contained in this paragraph shall be deemed to grant any license under any invention other than a Subject Invention. * * *

It is defendant's position that the Richter invention was inextricably related to the scope of research required in evaluating the "* * * radome-antenna configurations of AEW/CIC/DEW aircraft, including all pertinent independent and related aspects of radar and airplane performance, * * *" as set forth by amendment 14. Specifically, defendant's argument is premised on the contention that amendment 7 required Lockheed to conduct design studies on the previously-developed WV–2 radome antenna configurations using the top-mounted AN/APS–45 height finding radar with the top-mounted UHF search radar as an interim configuration if such a configuration provided CIC

capability. For this reason, defendant argues that the phrase "* * * to include capability for CIC with APS–45 as interim configuration * * *" was incorporated into amendment 7 of the contract by reference to Lockheed's August 27, 1954, proposal letter. Building on the above premises, defendant goes on to argue that since the feasibility of using the AN/APS–45 height finder in conjunction with the new UHF search radar was uncertain, amendments 7 and 14 called for a broad inquiry into radar design to achieve CIC capability. Consequently, the Government concludes that Richter's invention was an integral component of the preliminary research of the 1041–c contract, thus entitling the United States to a royalty-free license to practice the invention by virtue of the patent rights clause, relying on the decisions of this court in *Technitrol, Inc.* v. *United States*, 194 Ct.Cl. 596, 440 F.2d 1362 (1971), and *Mine Safety Appliances Co.* v. *United States*, 176 Ct.Cl. 777, 364 F.2d 385 (1966).

It is concluded, for reasons which follow, that defendant's analysis is incorrect.

This court has recently stated that in order to establish the close and umbilical connection which was necessary to its decisions in *Mine Safety* and *Technitrol*, a defendant must do more than "* * * broadly allude to various 'connections' or 'contacts' * * *" between an invention and a contract, but rather must supply hard facts to support its position that a license exists. *See Rel-Reeves, Inc.* v. *United States*, 186 USPQ 21 (Trial Div., Ct.Cl. 1975), 209 Ct.Cl. 595, 534 F.2d 274 (1976).

In *Mine Safety*, the University of Southern California (USC) had contracted with the Navy Department in April of 1946 to conduct research on the physiological, biochemical and anatomical effects of acceleration on the body as it related to pilot position in high speed aircraft. The contract contained the following patent rights clause (176 Ct.Cl. at 782, 364 F.2d at 388):

> (a) Where used in this Section, and not elsewhere in this contract, the expression "Subject Invention" means each invention, improvement and discovery (whether or not patentable) conceived or first actually reduced to practice (i) in the performance of this contract, * * * or

(ii) in the performance of any research or development work relating to the subject matter hereof which was done upon the understanding that this contract or any subcontract hereunder would be awarded * * *.

(b) Contractor agrees to and does hereby grant to the Government an irrevocable, non-exclusive, non-transferable and royalty-free license to practice, and cause to be practiced for the Government, throughout the world, each Subject Invention in the manufacture, use and disposition according to law of any article or material, and the use of any method * * *.

Concluding that the Government had reserved to itself a royalty-free license under the patent rights clause to practice a patent disclosing a crash helmet that was invented by two USC employees working in a USC aviation medicine program, the court premised its holding on a combination of several interrelated factors.

Specifically, the court, in finding a close connection between the Navy contract and the USC helmet program, noted several relevant indicia:

1. A final report by USC under a predecessor contract which indicated that personal protective gear necessary to decrease the hazards of crash landings would be undertaken;
2. Documentary evidence which indicated that both the Navy and USC expressly anticipated the development of better protective gear as a result of the contract work;
3. The close physical proximity of where the helmet project and contract work was performed;
4. The assignment, full-time, of one of the patentees to work under the contract, during which time the patented crash helmet was made; and
5. Post-invention documentary evidence which indicated that the Navy considered the development of crash helmet equipment to be part of the contract work and the USC's acquiescence in this position.

The court noted that (176 Ct.Cl. at 787, 364 F.2d at 391):

There was a close and umbilical connection which was not, and could not be, severed. We need not go so far as to say that the helmet program as a whole was an integral part of the Navy contract—though there is strong support for that position—but we do hold that the license clause of Section 17, *supra*, covered an invention so intimately tied to the work to be done under, and the

results anticipated from, that agreement. As suggested above, we read the scope of the Navy program in accordance with the parties' contemporaneous construction—and contrary to plaintiffs' present contention—as including from the beginning head-impact research within the contractual concept of "acceleration".

and concluded that (176 Ct.Cl. at 787–88, 364 F.2d at 391):

> At least in those instances in which the invention was conceived or practiced during the existence of the contract, it is enough that an important factor in the invention was itself within the contractual scope, or resulted directly from the course of contract performance. That is the import, as we understand it, of the general phrase "in the performance of this contract." It is immaterial, therefore, whether or not the practical development of impact head gear was, in and of itself, within the Navy agreement. That was only one aspect, though an important one, of the invention. The physiological, biochemical, and anatomical research on impact-acceleration and the study of energy-absorbing materials—which had to precede or accompany the practical head-gear applications—were also necessary and important components; and such research *was* an integral part of the contract. Without these contract-covered inquiries, the final invention would not have been made.

The contract language relied upon by defendant in asserting that the Richter invention falls within the contractual scope of the 1041–c contract is anything but a model of clarity of expression. The phrase "[d]esign studies to include capability for CIC" is at best speculative and varying interpretations are urged by the parties. Indeed, the language appearing in amendments 7 and 14, "including all pertinent independent and related aspects of radar and airplane performance" cannot be interpreted reasonably *in vacuo*.

Where such contractual language as appears here is unclear and suggests several speculative interpretations, the scope of the language must be read in accordance with the parties' contemporaneous construction, *Mine Safety*, *supra*, 176 Ct.Cl. at 787, 364 F.2d at 391, and extrinsic evidence is admissible to show what the parties intended it to mean. *Blackburn* v. *United States*, 126 Ct.Cl. 874, 877, 116 F.Supp. 584, 586 (1953).

A careful reading of the documentary evidence surrounding amendments 7 and 14 to the 1041–c contract leads to the conclusion that the parties' actual intent was to adapt the AN/APS–45 and AN/APS–20B radars (later replaced by the AN/APS–70) for use in the WV–2. In this light, Lockheed's contractual duties, specifically calling for studies of "all pertinent independent and related aspects of radar and airplane performance," are clearly understood to relate to a study of the effects of various radome-antenna configurations on the performance of the Government-furnished radar systems. Thus, it is concluded that the design of a new radar was not expressly contracted for.

Additionally, few, if any, of the factors which played a role in the decision of the court in *Mine Safety* that the helmet invention had a close and umbilical connection to the contract work appear in this case with respect to the Richter invention and the 1041–c contract.

Defendant attempts to bring the Richter invention within the purview of the contract retroactively by means of the reimbursement clause in amendment 14 to the 1041–c contract. However, the simple fact is that there is no evidence indicating that Lockheed ever actually received any money under this clause. Further, if money was paid to Lockheed thereunder, there is no evidence as to what specific work was compensated for, and there was certainly no evidence that Richter's invention was retroactively compensated for.

Defendant has not shown that the development of Richter's invention was causally connected to plaintiff's program to design a new radome-antenna assembly for the WV–2 under the 1041–c contract, since, independent of the 1041–c contract and indeed as far back as World War II, a need existed for a single radar to accomplish both height finding and searching.

A number of equally persuasive factors also distinguish the case at bar from *Mine Safety, supra.* To begin, the most that defendant has shown is that Richter performed routine production-type ground tests on the AN/APS–20B and AN/APS–45 radomes to see that they met performance specifications. The record is totally devoid of any evidence tending to show that Richter performed radar

design work under the 1041–c contract or that Lockheed was later reimbursed therefor. Thus, defendant is unable to argue, as was the case in *Mine Safety*, that Richter was only able to make his invention because of the knowledge he gained from his work under the 1041–c contract.

Additionally, the Navy was at least constructively notified of Richter's invention since it was disclosed by Richter to NRL, as well as Mr. Leo Puckett, the Government's project engineer for the avionics system electronics on the WV–2 aircraft. Further, the Navy Department's 1041–c contract file contained a statement signed by a Government official that the patent and royalty requirements of the contract had been complied with by Lockheed. This lends some further credence to the conclusion that the Richter invention was not felt to come within the scope of work called for by the 1041–c contract nor contemporaneously viewed as such by the parties.

In sum, defendant has failed to prove that the design of a radar system such as Richter's was expressly included in the 1041–c contract.

To the contrary, the evidence clearly shows that the parties continuously intended to use both an AN/APS–45 height finding radar and an AN/APS–20B (later replaced by the AN/APS–70B) search radar to fulfill the operational requirements of the 1041–c contract.

Obviously, defendant has not established the presence of such a "close and umbilical connection" between the contract work and the Richter invention as to justify a conclusion similar to that reached in the *Mine Safety* and *Technitrol* cases. To the contrary, the facts show that the Richter invention was not conceived in the performance of the experimental, developmental, or research work called for by the 1041–c contract.

Conclusion

It is concluded that claims 1, 2, 4, 5 and 7 to 10 of Richter patent 3,001,191 are valid and the inventions covered by claims 1, 2, 4, 5 and 8 to 10 are found to have been used and/or manufactured by or for the defendant without authorization or license from plaintiff.

Syllabus

CONCLUSION OF LAW

Upon the findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that claims 1, 2, 4, 5 and 7 to 10 of United States Letters Patent No. 3,001,191 are valid and the inventions defined by claims 1, 2, 4, 5 and 8 to 10 have been used and/or manufactured by or for defendant without authorization or license from plaintiff, that plaintiff is entitled to recover reasonable and entire compensation therefor, and judgment is entered to that effect. The amount of recovery will be determined pursuant to Rule 131(c) (2).

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551 F.2d 291

MARGARET L. PELZ, ET AL. v. THE UNITED STATES

[No. 8–74. Decided March 23, 1977]

ON THE PROOFS

Taxes; income tax; exclusions from gross income; scholarships and fellowship grants; teaching assistants.—During 1967–71 plaintiffs were teaching assistants in the Classics Department of the University of Washington and received monthly stipends from the university. The State of Washington furnished these funds. Plaintiffs were also enrolled in the Classics Department as full-time graduate students pursuing their doctorates in the classics. In order to compete with other universities and to attract promising classics doctoral candidates, the Classics Department has found it necessary to provide financial assistance to most of the students participating in the program, for instance in the form of teaching assistantships. Plaintiffs contend that said stipends did not constitute taxable income but should be regarded as scholarships or fellowship grants within the meaning of Sec. 117(a) of the Code. It is *held* that the stipends were not scholarships or fellowship grants but represented payments for teaching in the nature of part-time employment required as a condition to receiving the stipends, and, hence, were subject to income tax. The teaching done by plaintiffs was not "such teaching" as provided in Sec. 117(b)(1) as was required of all candidates for doctorates in the classics. Plaintiffs are not entitled to recover and the petition is dismissed.

Taxes; income tax; gross income, exclusions from; scholarships and fellowship grants; teaching assistants.

[1] Stipends paid by the university for teaching assistants who were also candidates for doctorates in the same department, were subject to

Opinion of Trial Judge

the Federal income tax as compensation for teaching services and were not fellowship grants or scholarships, as those terms are used in Sec. 117(a) of the Code, where, *inter alia*, the assistants, but not the fellows, were required to furnish teaching services as a condition to receiving the stipends, the stipends were paid through the payroll system with funds provided by the state for procurement of instructional services, and income and social security taxes were withheld by the university.

Internal Revenue ⇐305

Eugene M. Moen, attorney of record, for plaintiffs. *Halverson, Strong, Moen & Chemnick*, of counsel.

Kenneth R. Pike, with whom was *Acting Assistant Attorney General Myron C. Baum*, for defendant. *Theodore D. Peyser* and *Donald H. Olson*, of counsel.

Before COWEN, *Senior Judge*, NICHOLS and KASHIWA, *Judges*.

PER CURIAM: This case comes before the court on defendant's motion, filed January 3, 1977, moving that the court adopt the recommended decision of Senior Trial Judge Mastin G. White, filed November 16, 1976, pursuant to Rule 134(h), as the basis for its judgment in this case, plaintiff having failed to file a notice of intention to except thereto and the time for so filing having expired. Upon consideration thereof, without oral argument, since the court agrees with the said recommended decision, as hereinafter set forth*, it hereby grants defendant's motion and affirms and adopts the decision as the basis for its judgment in this case. Therefore, it is concluded that plaintiffs are not entitled to recover and their petition is dismissed.

OPINION OF TRIAL JUDGE

WHITE, *Senior Trial Judge:* Margaret L. Pelz, Rochelle E. Snee, Patrick Michael McKeehan, and Ante T. Elezovic[1]

* Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed November 16, 1976, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

[1] The plaintiff Laine Henline Elezovic is the wife of Ante T. Elezovic and is a party to this action only because she joined her husband Ante T. Elezovic in filing income tax returns for periods that are involved in the litigation.

("the plaintiffs") were teaching assistants in the Classics Department of the University of Washington during certain quarter-years in the 1967–71 period, and they received from the university monthly stipends while holding such teaching assistantships. In addition to performing the teaching duties required of them as teaching assistants, the plaintiffs were enrolled in the Classics Department as full-time graduate students pursuing courses of study leading to the degree of Doctor of Philosophy in the classics.

The Internal Revenue Service required the plaintiffs to pay federal income taxes on the stipends which they received as teaching assistants; and the plaintiffs now sue to recover the amounts so paid, together with statutory interest.

The plaintiffs contend that their monthly stipends as teaching assistants did not constitute taxable income because: (1) subsection (a) of section 117 of the Internal Revenue Code of 1954 (26 U.S.C. § 117(a)) provides in part that an individual's gross income does not include any amount received "as a scholarship at an educational institution" or "as a fellowship grant"; (2) the pertinent regulation (26 C.F.R. § 1.117–3(a) and (c)) defines a "scholarship" and a "fellowship grant" in similar language as "an amount paid or allowed to, or for the benefit of," a student (or other individual, in the case of a fellowship grant) to "aid" such individual in pursuing his or her studies (or research, in the case of a fellowship grant); and (3) as shown by the evidence in this record, the primary purpose of the Classics Department in awarding teaching assistantships to the plaintiffs and to other graduate students was to provide financial assistance to the recipients as they pursued their courses of study leading to the doctorate in the classics.

Therefore, according to the plaintiffs, their stipends as teaching assistants should be regarded as scholarships or fellowship grants for income tax purposes, even if such stipends were not so designated in the nomenclature of the University of Washington.

The graduate program leading to the doctorate in the classics was inaugurated by the Classics Department of the

University of Washington in 1960, and has been continued until the present time. In order to compete with other prestigious universities and attract promising doctoral candidates in the field of the classics, and thus make possible the continuation of the program for Ph.D. candidates, it has been, and still is, necessary for the Classics Department to be able to offer and provide financial assistance of some sort to most of the graduate students taking part in this program (although financial need, *per se*, has never been a factor in awarding financial assistance to particular graduate students).

During the years involved in the present litigation, the Classics Department was able to make financial assistance available to its graduate students principally in the form of teaching assistantships, and secondarily in the form of National Defense Education Act ("NDEA") fellowships. For example, the number of teaching assistantships awarded to graduate students in the Classics Department ranged from a high of 18 in 1968 (when 9 NDEA fellowships were awarded) to a low of 11 in 1971 (when 5 NDEA fellowships were awarded). None of the plaintiffs ever held an NDEA fellowship (or any other form of grant denominated a fellowship or scholarship by the University of Washington) during the period in question, but all of them were awarded and held teaching assistantships.

Funds for the NDEA fellowship grants were derived from the Federal Government, while funds for the stipends of the teaching assistants were derived from the State of Washington, in accordance with the procedure outlined in the next succeeding paragraph of this opinion.

The state legislature made available to the University of Washington, out of the general fund of the State of Washington, money for instructional and teaching purposes, by approving a university budget which provided for faculty "counts" on the basis of a formula that evaluated instructional needs in terms of the number of student credit hours (at different levels of difficulty) taught during the previous year. The university administration, on the basis of the same formula, allocated the faculty "counts" to the different colleges and schools comprising the university. The College of Arts and Sciences, of which the Classics

Department was and is a part, made a further allocation of the college's faculty "counts" to the departments comprising the college, including the Classics Department. A faculty "count" authorized the maintenance by a department of one regular faculty position or four teaching assistantships.

A department within the College of Arts and Sciences, including the Classics Department, had the discretionary authority to determine the extent to which its faculty "counts" would be used for the maintenance of regular faculty positions and the extent to which the "counts" would be used for the maintenance of teaching assistantships.[2] The Classics Department consciously chose to utilize its allocation of faculty "counts" in order to maintain an unusually large number of teaching assistantships, in comparison with the number of regular faculty positions maintained by the department. In 1968, for example, the Classics Department had 17 teaching assistants and only 8 regular faculty members. This disproportion of teaching assistants in relation to faculty members was decided upon by the department because it was necessary for the department to offer and provide financial assistance to graduate students in order to attract promising doctoral candidates, and funds from other sources for this purpose were limited. From the standpoint of the Classics Department, therefore, the teaching assistantships were regarded primarily as a means of providing financial assistance to promising graduate students in order to maintain a viable doctoral program in the classics.

In my opinion, however, the primary purpose or motivation of the Classics Department in establishing and maintaining the teaching assistantships is not controlling, or even particularly significant, in the present case. The money with which to pay the stipends of the teaching assistants came out of the general fund of the State of Washington and was made available by the state legislature to the University of Washington specifically for the procurement of instructional and teaching services. The

[2] The dean of the college exercised general supervision in this field and could act to prevent abuses of discretion.

use of this money for grants, gifts, or gratuities of any kind would have been outside the scope of the legislative authorization. Under a state statutory provision (Revised Code of Washington Annotated 43.88.160(2)(d)), it was necessary to certify that "services have been rendered" in connection with the disbursement of this money.

From the standpoint of the State of Washington (which provided the money for the stipends of teaching assistants), from the standpoint of the University of Washington, and from the standpoint of the College of Arts and Sciences, teaching assistants were persons employed to provide instructional and teaching services to university students.

Furthermore, the plaintiffs (and other teaching assistants in the Classics Department) actually were required to, and did, perform teaching services in order to receive their stipends. Teaching assistants were supposed to work on a half-time basis and to devote approximately 20 hours per week to the performance of their duties (although their actual working time was generally less than 20 hours per week). Ordinarily, a teaching assistant in the Classics Department was assigned to teach two courses (or sections of courses) each quarter, although sometimes, when undergraduate enrollment in the classics courses was comparatively low (this was apt to be true in the spring quarter), a teaching assistant might be assigned to teach only one course (or section) during a quarter. It should be mentioned, in this connection, that a teaching assistant's stipend remained the same, irrespective of whether he was assigned to teach two courses or only one course during a particular quarter.

That the plaintiffs and the other teaching assistants in the Classics Department rendered valuable services to the department and to the university is shown by the fact that, according to the evidence, it would have been necessary for the department to appoint additional regular faculty members to handle the teaching load in the department during the 1967–71 period if the services of the teaching assistants had not been available. It is pertinent to note, in this connection, that the teaching assistants performed their teaching duties with very little, if any, supervision from the regular faculty members. The teaching assistants

were, in actuality, teachers like the regular faculty members, although lacking tenure and employed on a year-by-year basis, up to a maximum of 5 years; and the teaching assistants, like the regular faculty members, were paid for their services out of a fund provided by the State of Washington for the procurement of instructional services.

The University of Washington made a sharp distinction between teaching assistants, on the one hand, and the holders of fellowships, on the other hand, in the following respects (among others): (1) teaching assistants were required to furnish teaching services in order to receive their stipends, while fellows were not required to furnish any sort of service in return for their stipends; (2) teaching assistants' stipends were paid with money provided by the State of Washington for the procurement of instructional services, while fellows' stipends were paid with non-state money donated to the University of Washington; (3) teaching assistants were paid through the payroll system, while fellowship payments were made through the financial accounting system; (4) teaching assistants were placed on the payroll through the use of an "Employment Notice" form, while fellows were appointed through the use of a "Grant-in-Aid, Fellowship, or Trainee Appointment" form; (5) teaching assistants received cost-of-living increases, while fellows did not; and (6) income taxes and social security taxes were withheld on amounts paid to teaching assistants, but no such withholdings were made on amounts paid to fellows.

It must be concluded that the plaintiffs' stipends as teaching assistants were not fellowship grants or scholarships, as those terms are used in subsection (a) of section 117 of the Internal Revenue Code of 1954, but, rather, were payments for services rendered and, hence, were subject to the income tax.

Furthermore, even if the plaintiffs' stipends had been officially designated as fellowship grants or scholarships in the local terminology, such stipends would still be taxable.

Subsection (b)(1) of section 117 of the 1954 Code provides in part as follows:

(b) *Limitations.*—

Conclusion of Law

(1) *Individuals who are candidates for degrees.*—In the case of an individual who is a candidate for a degree at an educational institution * * *, subsection (a) [excluding scholarships and fellowship grants from gross income] shall not apply to that portion of any amount received which represents payment for teaching * * * or other services in the nature of part-time employment required as a condition to receiving the scholarship or the fellowship grant. If teaching * * * or other services are required of all candidates * * * for a particular degree as a condition to receiving such degree, such teaching * * * or other services shall not be regarded as part-time employment within the meaning of this paragraph.

As stated previously in this opinion, the stipends received by the plaintiffs represented "payment for teaching * * * in the nature of part-time employment required as a condition to receiving" the stipends in question; and the teaching done by the plaintiffs was not "such teaching" as was required of all candidates for the Ph.D. degree in the classics.

It is true that the Classics Department in 1968 adopted a rule, which was applicable prospectively to graduate students entering that department's doctoral program in 1968 or thereafter, whereby a doctoral candidate must have "teaching experience" in order to qualify for the Ph.D. degree in the classics. Neither the amount nor the nature of the required teaching experience is specified in the rule. However, there is nothing in the record to indicate that the rule requires "all candidates" for the Ph.D. degree in the classics to have the kind or the extent of teaching experience that the plaintiffs had as teaching assistants during the 1967–71 period.

In any event, therefore, the plaintiffs' stipends as teaching assistants would be removed from the scope of subsection (a) of section 117 of the 1954 Code, even if such stipends had been called fellowship grants or scholarships.

It necessarily follows that the plaintiffs are not entitled to recover, and the petition should be dismissed.

CONCLUSION OF LAW

Upon the trial judge's findings and opinion, which are adopted by the court, the court concludes as a matter of

law that the plaintiffs are not entitled to recover, and the petition is therefore dismissed.

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556 F. 2d 1118

BLUE BELL, INC. v. THE UNITED STATES

[No. 603–71. Decided April 8, 1977]

ON THE PROOFS

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; conversion and reconversion of facilities; personnel training; Government-furnished materials.—This is a suit for redetermination of excessive profits for plaintiff's fiscal year ended October 31, 1967 under renegotiable contracts and subcontracts for production of military trousers. Prior to its defense "rated order" in January 1966, approximately 80% of the production of plaintiff's predecessor was by contract for manufacture of men's and boys' casual slacks, work clothes and jeans for large retail outlets. The Government contracts necessitated retraining employees and conversion of facilities. In 1968 plaintiff reconverted its facilities to civilian business. Plaintiff seeks redetermination of the order of the Renegotiation Board that it realized $275,000 in excessive profits. After analyzing all of the statutory factors of 50 U.S.C. App. § 1213 as applied to this case, and for the reasons given, it is *held* that plaintiff, as successor in interest, realized excessive profits of $150,000 for its fiscal year ended October 31, 1967. The case is remanded to the trial judge for further proceedings in the event the parties are unable to agree as to the appropriate allowance for state and Federal income taxes and interest on the net amount to be repaid to the Government by plaintiff.

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; extent of risk assumed.

[1] Where the Government is unable, or unwilling, to support enough production capacity to meet its limited emergency defense requirements, by its regular suppliers, it should expect to extend special renegotiation recognition or allowance under the statutory risk factor of 50 U.S.C. App. § 1213(e)(3) to those suppliers temporarily brought in against their own volition under "rated orders" to fill the void, and not by comparing what the latter would earn in its normal peacetime business, which he was obliged to temporarily abandon in part, or what a regular supplier of an item would earn, which the one undergoing renegotiation supplied as a temporary emergency contribution.

War and National Defense ⚿59

Syllabus

Renegotiation of contracts; redetermination of excessive profits; Government-furnished material.

[2] In comparing plaintiff's civilian business, where its materials were customer-financed, with its military business under renegotiation, where its materials were Government-furnished, for factor analysis purposes in redetermination of excessive profits, if any, on its Government contract, the Government-furnished material should be added to costs and sales to compare them with the civilian costs and sales, or the material cost in the civilian business should be excluded (except for the 20% of plaintiff's commercial sales from inventories with respect to which plaintiff bore all risks and burdens of costs), or both.

War and National Defense ⚷59

Renegotiation of contracts; redetermination of excessive profits; evidence; burden of proof and persuasion.

[3] The Government, in seeking return of monies pursuant to 50 U.S.C. App. §§ 1211 et seq., bears the burden of proving that the renegotiated contractor realized excessive profits and that the extent of that excess was as the Government claims.

War and National Defense ⚷59

Renegotiation of contracts; redetermination of excessive profits; generally.

[4] Excessive profits determinations are factual in nature.

War and National Defense ⚷59

Renegotiation of contracts; redetermination of excessive profits; profit-sharing and bonus contributions, allocation of.

[5] Where plaintiff for income tax purposes treated expenses of its profit-sharing plan for employees and its bonus plan for corporate officers, incurred only to the extent of profits, as general and administrative expenses in the nature of additional salaries, in redetermining plaintiff's excessive profits under its defense contract, the contributions, as salaries, were necessary and ordinary expenses of the business to be allocated between plaintiff's renegotiable and normal commercial business as other salaries and expenses, rather than as cost of goods sold.

War and National Defense ⚷59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; extent of risk assumed; reconversion costs.

[6] While 50 U.S.C. App. § 1213(f) prohibits carrybacks of cost from another year in computing excessive profits, this does not necessarily mean that related items of cost in a succeeding year which are triggered by the renegotiable year's business may not be considered as a necessary or probable risk item for which a contractor should receive an allowance. Thus, although renegotiated plaintiff is entitled to some allowance for reconversion to civilian production in redetermining its excessive profits, the allowance should not be recognized as a separate item of cost, but should be subsumed in an upward profit adjustment for risk-bearing as attributable to forced entry into a specialized and

temporary market by virtue of "rated orders." Conversion and reconversion expenses, personnel retraining and unabsorbed overhead are all implicit as consequences.

War and National Defense ⚖59

Renegotiation of contracts; redetermination of excessive profits; factors to be considered; contribution to defense effort.

[7] Where the record shows that plaintiff under its renegotiable contract furnished well-manufactured goods, the rejection rate was minute, its deliveries were on schedule, its performance record was rated as excellent and it was issued a Quality Award by the Government, favorable consideration is appropriate under 50 U.S.C. App. § 1213(f)(4).

War and National Defense ⚖59

Eric R. Fox, attorney of record, for plaintiff. *Ivins, Phillips & Barker*, of counsel.

John Charles Ranney, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before SKELTON, NICHOLS, and BENNETT, *Judges*.

Per Curiam: This is a petition transferred from the United States Tax Court, where it was originally filed, for redetermination of plaintiff's excessive profits for its fiscal year ended October 31, 1967, as received or accrued by its predecessor in interest, Hicks-Ponder Company, under defense contracts and subcontracts. We have jurisdiction under 50 U.S.C. App. § 1218, *as amended*. The Renegotiation Board, by its unilateral order dated May 14, 1970, determined that plaintiff realized excessive profits in the amount of $275,000, there being no adjustment for state income taxes, and before computation of the Federal tax credit.

The case was tried before Trial Judge Philip R. Miller who has submitted a recommended decision and conclusion of law under Rule 134(h). After briefing and oral argument, the court partly agrees with the said recommended decision, with modifications, and adopts the same as its own, with modifications. Said modifications include the omission of all of Part H and substitution of the paragraphs immediately following, in the court's own words, leaning heavily on the Trial Judge's reasoning, but not

repeating it, particularly where it is anticipated by our decision in *Major Coat Co.* v. *United States*, 211 Ct. Cl. 1, 543 F.2d 97 (1976), which was tried after, but decided before, the instant case.

Hicks-Ponder in 1966 was a successful and growing manufacturer of men's and boys' casual slacks, work clothes, and jeans. It had plants along the Mexican Border at Eagle Pass, Del Rio, and El Paso, Texas, and at Yuma, Arizona. Approximately 80 percent of its production was by contract for large retail outlets such as Sears Roebuck, Montgomery Ward, and J. C. Penny. It had not done Government business for many years. In January 1966, it received a "rated order" from the Defense Supply Agency (DSA) for the manufacture of 160,000 pairs of men's fatigue trousers, following discussions that had continued for some time. The Trial Judge describes the circumstances in more detail. The action was, of course, a result of the growing requirements of the war or quasi-war in Southeast Asia.

The order necessitated retraining of employees, and conversion of facilities, despite the apparent resemblances, to the uninitiated, of civilian and military pants. Plaintiff's executives did not believe they could retrieve the expenses thus incurred unless they were given follow on orders which were not guaranteed. They could keep their facilities operating at capacity, and expanding, with civilian business. They doubted their ability to compete for Government business with its regular suppliers when competitive conditions returned. For these reasons, as a matter of business judgment, the plaintiff's executives were much opposed to accepting the order, and would not have done so if they had not believed that coercive measures would be applied against them, in case of refusal, and if they had not believed in the existence of an emergency, wherein their assistance was greatly needed. The legal foundation and effect of a rated order is stated in *Major Coat, Co., supra.* But according to a knowledgeable Government witness, it was not so much a matter of direct arm-twisting as a dawning realization that those who accepted rated orders could extend them to divert from noncooperating manufacturers the mill products, the textiles, they all needed to keep producing, and which would be in short supply. At

any rate, the Government was able to place its rated orders without great difficulty, other producers yielding after initial reluctance, as plaintiff did, so no overt coercion was necessary. Still, a rated order is a rated order.

In *Major Coat Co., supra,* plaintiff accepted a similar rated order, for coats, and the adverse consequences to its civilian business were serious and so far as appears, irreparable. The consequences of entering military production, to plaintiff here, were less serious, though they did include a permanent loss of Sears Roebuck as a customer for work pants. Sears was retained for other business.

Once one was started on military production, to stay on it was the path of least resistance, if only to avert or delay another set of retraining and conversion expenses. Thus, after the use of rated orders had ceased, we see plaintiff bidding still for both prime and subcontract requirements for military pants. Such bids may be deemed to have been caused by the original rated order. As anticipated, plaintiff was unable to compete when competitive conditions fully returned, so it then, in 1968, reconverted all its facilities to civilian business as soon as might be.

In World War II, when the economy was fully converted to war production, (except for the bare minimum of essential civilian needs) we suppose all defense orders to private industry were "rated" and such ratings were welcome, for without having them to extend, a producer surely could not obtain needed materials and might be in difficulty as to labor. In World War II renegotiations, the ratings were so universal in the background that they were not even mentioned. A mention would not distinguish one case from another. However, we see in 1966–68 an economy with, in general, no mandatory conversion. We had, as the slogan went, "guns *and* butter." In such circumstances, the use of war powers to force military production on a small group of producers in a particular industry only, while the suppliers of other war material are those who desire to do that business, is to present problems to us if we are to renegotiate with fairness to all concerned. The Government procurement authorities fully recognized that they owed plaintiff special consideration. They were willing to negotiate any price, within reason and having justifica-

tion, and the prices to plaintiff at least were much above what had been the going rate a few months earlier. Finding 115 shows that some awards at the time, under the same program, were at higher prices, and some were at lower, than plaintiff's. Is it fair to take away this special concession in renegotiation, and reduce plaintiff to the same ratio of profit to sales as is allowed to a producer who makes pants for the military at all times and of his own volition?

It would appear that the statutory risk factor, 50 U.S.C. App. § 1213(e)(3), would support some favorable allowance here, both as compared to what the contractor would earn in his normal peacetime business, which he is obliged to abandon in part, for the nonce, and as compared to what a regular supplier of an item would earn, which the contractor undergoing renegotiation supplied as a temporary emergency contribution. "Where a risk is borne that is not compensated in any comparable firm's profit" [here, a comparable of one of two above kinds] "it is nonetheless compensable by an upward adjustment of an otherwise reasonable profit for the risk-bearer, however judgmental in nature that adjustment must be." *Major Coat Co. v. United States, supra*, 211 Ct. Cl. at 40, 543 F. 2d at 119. If the Government is unable, or unwilling, to support enough production capacity to meet the needs of this limited emergency, by its regular suppliers, it should expect to extend some kind of special recognition to those temporarily brought in against their own volition, to fill the void. The issue reduces itself to one of quantum.

By the requirements of the fiscal year method, conversion costs incurred in 1966 were largely ineffective to reduce the renegotiable 1967 profit. The defense contracts were commenced in fiscal 1966, carried on in fiscal 1967, and completed in fiscal 1968, but a disproportionate amount of the costs were incurred in 1966 and 1968, causing the renegotiable 1967 profit to appear larger than it would have, stated as a percentage of sales, if all the defense business had been renegotiated in a single determination, as plaintiff would have us do. There is no authority for conducting the case in that manner and we must reject the invitation to do it. As to 1966, the receipts were at any

rate enough to cover the startup and conversion costs, and show a modest profit. The problem of determining a fair reconversion allowance is dealt with in the Trial Judge's opinion, and the difficulties are manifest. The reconversion costs were not directly allocable to renegotiable business in an accounting sense, but rather to the new civilian business that replaced the Government business. The claim for delays in picking up civilian business in 1968, are speculative in the extreme. We think that some reconversion allowance is mandated not as a cost but as an element to be considered in factor analysis. *Butkin Precision Mfg. Co.* v. *United States*, 211 Ct. Cl. 110, 544 F. 2d 499 (1976). It should not be allowed as a separate item, but should be subsumed in an upward profit adjustment for risk-bearing as attributable to forced entry into a specialized and temporary market, by virtue of the rated orders, as discussed above. Conversion and reconversion expenses, personnel retraining, and unabsorbed overhead, were all implicit as consequences.

In comparison of plaintiff's own civilian business with the military business under renegotiation, we approve in general the treatment of the material components to make them validly comparable, as the Trial Judge has done. That is, we think that for factor analysis purposes the Government Furnished Material (GFM) should be added to costs and sales to compare them with the civilian costs and sales, or else the material cost in the civilian business should be excluded (except for the 20 percent produced for inventory) or else, as the Trial Judge does, both. It seems clear that when the Government was not the buyer, the big private outlets such as Sears Roebuck very largely relieved Hicks-Ponder from having capital tied up in their work in progress. They ordered the textiles from the mills, allotted and sold them to plaintiff and plaintiff had 70 days from delivery in which to pay. Our analysis of the GFM problem in *Major Coat* is fully applicable here.

The Board in its statement of reasons said that the returns on capital employed and net worth were high and indicative of excessive profits. It noted the GFM as capital furnished by the Government, in effect, and also that plaintiff made extensive use of plants and machinery

rented from affiliated companies. Whatever information the Board may have had, the record here does not show whether the kind of capital assistance the Government rendered via the GFM, the same in substance as plaintiff's big contract customers also rendered, was not usual in the plaintiff's industry. The Board has elsewhere recognized that use of rented facilities tends to remove the capital and net worth factor from relevant application. *See Butkin Precision Mfg. Co.* v. *United States, supra.* As there suggested, if facilities are rented from an affiliated owner, really the owner's interest should be consolidated for application of this factor. There is nothing in our record to show that the low ratio of capital employed to volume of business done, as well as to profits is not normal and usual in the industry plaintiff is a member of. In the absence of comparable data as to other companies the information as to capital and net worth in our record is meaningless. *Aero Spaceline, Inc.* v. *United States*, 208 Ct. Cl. 704, 748, 751–52, 530 F. 2d 324, 351, 353 (1976). Nor have we had the benefit of any kind of expert testimony to interpret the meaning of such information. By calculations the Trial Judge accepted, the capital and net worth allocated to renegotiable business had a lower ratio to profit from renegotiable business, than the capital and net worth allocated to civilian business had to profit from civilian business. But that is just another way of noting the fact, obvious in the record, that the procurement authorities allowed plaintiff more profit per unit on military business, than it was getting on civilian business. If the reasons for doing this were not good, we do not need the capital and net worth factor to tell us we should require a refund; if they were good, the factor does not make them bad. The factor cannot be used for this kind of a bootstrap argument; for any valid use of it, comparisons to other companies of the same kind are necessary. Some industries need more capital than others, and defendant, having the burden of proof, could easily have told us what the capital needs of typical companies in plaintiff's industry were.

Here, as in some other renegotiation cases tried before us, the absence of expert testimony is a sore handicap to the trier of fact. Here, too, the absence of relevant

comparisons is almost total. We know by Finding 114, of companies participating in the program, other than plaintiff; the Board cleared four, one of which earned (excluding GFM) as much as 13.7 percent of sales, and exacted refunds from eight, including plaintiff, leaving them with profit 14.4 percent to 10.6 percent of adjusted sales. The Board must have learned all about these companies, but nothing has been allowed to transpire in the proceeding before us that would enable a comparison to be made according to the standards laid down in *Major Coat*, *Butkin*, and other of our cases. It is defendant that must suffer from this paucity of evidence, as it has the burden of proof.

From the nature of things, with plaintiff appealing from a Board determination, we cannot use the determination appealed from as a comparison, nor those made with respect to the other companies mentioned in Finding 114. Compare *Major Coat Co.* v. *United States*, *supra*, 211 Ct. Cl. at 43–44, 543 F. 2d at 121–122. If we could, the comparisons would be but superficial since we are vouchsafed no data as to their similarities to plaintiff or their differences, nor do we know how plaintiff places among them as to relative efficiency. Defendant in moving for rehearing in *Major Coat*, urged the difficulty of defining the relevant industry and obtaining the relevant comparative data. However great such problems may be in some cases, they hardly can be said to exist here. Since defendant has the burden of proof, the absence of this almost indispensible data could well lead to a clearance determination; however, in view of the comparative novelty of trials under the burden of proof rules we have prescribed, here as in *Major Coat*, we will attempt to construct an equitable refund determination with the scanty material provided.

The Trial Judge, in the portion of his opinion we have deleted, showed that a reduction of the profit level on renegotiable business to that shown on the civilian sales of the same year would reduce allowable profits to $146,000 and require a refund of $347,000, but this was on the inadmissible premise of excluding GFM from sales and costs, while making no comparable adjustment in the civilian sales. If one reconstructed renegotiable sales and costs to include GFM, the excessive profits would be

$237,000. But if one excluded the GFM from the Government business and made a corresponding exclusion of the textile products used from the commercial business, the excessive profits elimination to reduce the renegotiable profits to the commercial level would be $202,000. The Trial Judge then averaged these two figures since they were alternative computations to accomplish the same result, producing an excessive profit figure of $220,000. He raised this to $237,500, however, to reflect the extent to which he supposed the risks and burdens of commercial material acquisition exceeded those involved in dealing with GFM. He raised this to $251,000 to account for a presumed interest saving from the use of GFM. There is no record evidence to support these adjustments. *Cf, Major Coat Co.* v. *United States, supra,* 211 Ct. Cl. at 18–21, 543 F. 2d at 107–08. He made an alternative computation based on capital and net worth, resulting in a figure of $228,000 or $229,000. We have already shown why we believe capital and net worth are out of court in this case. The Trial Judge attached little weight to results from application of that factor for reasons we believe are only less cogent. Finally, he subtracted $40,000 for 1968 reconversion costs, making an ultimate determination of $211,000. This would allow $282,000 retained profit on renegotiable business or, according to him, 12.21 percent of sales. The correct percentage is 13.43 percent. He failed to adjust the sales by the excessive profits to be eliminated, as he should have done. *Gibraltar Mfg. Co.* v. *United States,* 212 Ct. Cl. 226, 231, 546 F. 2d 386, 389 (1976).

The Trial Judge compares his result to that in *Winfield Mfg. Co.,* 57 T.C. 439 (1971). This was a proceeding retained by the Tax Court as it had been processed too far along for transferability here under Pub. L. No. 92–41, § 3, 85 Stat. 97 (1971). It involved the 1966 year of a company that produced for DSA poplin wind-resistant trousers and cotton sateen trousers, such as plaintiff also produced. Its following 1967 year is included in the tabulation in Finding 114 herein. Counsel advised that Winfield also appealed the 1967 determination but it has been settled without adjudication. Winfield differed from the plaintiff in that it was a regular producer of military clothing. The Board

determined a refund of $275,000. The Tax Court reduced this to $100,000. The Trial Judge was under the impression that this allowed 12.23 percent of sales, a figure closely comparable to his own 12.21 percent. But one percentage is as mistaken as the other. The correct percentage of retained profit to adjusted sales, in *Winfield*, is 15.43 percent. From statements here and there in the published *Winfield* decision, we summarize that decision as follows:

Reneg. Sales	$3,598,757
Reneg. Profits	640,014
Percent profits to sales	17.78%
Profits to be eliminated	$ 100,000
Adjusted sales	3,498,757
Adjusted profits	540,014
Percent adj. profit to adj. sales	15.43%

GFM was excluded from sales and costs, but given consideration as set forth in the opinion.

This decision would not be so very important here if we had other adequate comparables. From the fact we do not have them, it gains importance. It is not *res judicata* or even *stare decisis*, because excessive profits determinations are factual in nature. *Newport News Shipbuilding Co.* v. *United States*, 179 Ct. Cl. 97, 374 F. 2d 516 (1967). It rests on its own record, necessarily different from ours. However, defendant has not shown any reason why Winfield should be left after renegotiation with a far higher percentage of adjusted profit to adjusted sales than Blue Bell, Inc., is. Winfield was allowed a lower percentage by the Board than plaintiff, in the 1967 determinations (Finding 114). The Trial Judge evidently thought his own determination should come close to that in *Winfield*, and it seems reasonable to suppose that if he had computed the percentages in the two cases correctly, he would have considered allowing a higher retained profit percentage than he did. His own figures work out as 13.43 percent (see below) as compared to the Winfield 15.43 percent.

We follow the Trial Judge as far along the road he chose as the refund figure of $220,000 as a "starting point," *Butkin Precision Mfg. Co.* v. *United States*, *supra*, 211 Ct.

Cl. at 121–22, 544 F. 2d at 505–06, based on allowing the same profit percentage for civilian and military sales, after proper adjustments to make the treatment of customer-furnished or -financed material comparable. There is nothing in the record to refute the comparability of the civilian and military business, except that the latter was somewhat more complex, or at least required more manufacturing steps. We differ as to the presumed interest saving and adjustment to the GFM. We reject the supporting calculation based on capital and net worth.

Instead of a laborious attempt to determine actual reconversion costs, the allowability of which is difficult to determine, we favor allowing a percentage upward adjustment to cover and subsume such costs. However the GFM is treated, we think neither the rate of profit plaintiff enjoyed on its civilian business, to the extent it was permitted to remain in such business, nor the rate of compensation to others who were regular military suppliers, are reasonably sufficient to compensate plaintiff for incurring the burdens of a military supplier, involuntarily, for a brief period, and then the other burdens of giving up that business, equally involuntarily. We have the authority of defendant's expert in the *Butkin* case, *supra*, as to the propriety of making percentage allowances, under authority of the factors, in lieu of attempting to compute and reallocate to the renegotiable year costs allowable under the Internal Revenue Code only for other years, or not allowable at all for any year. Such allowances are necessarily painted with a broad brush and need not turn on disputes about component sums, nor do they necessitate resolution of doubtful allowability and allocability issues, one being traded off, as it were, against another. We followed defendant's expert in that case to the extent of using his percentage allowances as additions to the "starting point" there used. The Trial Judge found the cost impact of the conversion and reconversion here to be moderate, assessing the latter at $40,000, but if there had been none at all, we do not think the availability of the suggested allowance would have been refuted, at least in some perhaps smaller amount, since credit under the "risk" factor does not depend on the risk being realized in

the actual experience of loss or misfortune. The function of a risk actually realized in a loss, is to resolve all dispute whether the risk actually existed.

As a result of our deliberations above, we determine as a matter of judgment that the plaintiff is entitled to a profit adjustment of 3 percent of sales, that is 3 percent of the figure of $2,310,000, to be added to the "starting point" figure. The percentage would of course be less if computed on sales including GFM. The allowance is rounded off at $70,000. Subtracting this from the tentative excessive profits of $220,000, we have a determined figure of $150,000, as the excessive profits to be eliminated.

The portions of the opinion we have adopted, with minor changes, gives our analysis under the statutory factors. We consider our determination reasonable in light of all of them.

The determinations compare as follows:

	Board	*Trial Judge*	*Court*
Reneg. Sales	$2,309,810	$2,310,000	$2,310,000
Reneg. Profit	521,211	493,000	493,000
Percent Profit to Sales	22.6%	21.34%	21.34%
Profit to be eliminated	$ 275,000	$ 211,000	$ 150,000
Adjusted sales	2,034,810	2,099,000	2,160,000
Adjusted profit	246,211	282,000	343,000
Percent adj. profit to adj. sales	12.1%	13.4%	15.88%

Upon the following findings of fact and for the reasons set forth in the opinion, pursuant to Rule 148, the court concludes and determines as a matter of law that plaintiff as successor in interest to the Hicks-Ponder Company realized excessive profits of $150,000 for its fiscal year ended October 31, 1967, from contracts and subcontracts subject to renegotiation under the Renegotiation Act of 1951, as amended. The case is remanded to the Trial Judge for further proceedings in the event the parties are unable to agree as to the appropriate allowance for state and Federal income taxes and interest on the net amount to be repaid to the Government by plaintiff.

The Trial Judge's opinion, as modified by the court, follows:

OPINION OF TRIAL JUDGE

MILLER, *Trial Judge:* This is a suit for redetermination of the excessive profits, if any, for the fiscal year ended October 31, 1967, to be refunded by Blue Bell, Inc., on contracts for the production of military trousers. Blue Bell is the successor in interest to the Hicks-Ponder Company, the government contractor, as a result of a merger effective March 31, 1969. Except as otherwise noted, the term plaintiff will be used interchangeably to refer to either or both companies. References hereinafter to plaintiff's 1967 year and to its other peripheral years will refer to the fiscal year ended October 31.

The Renegotiation Board determined that of $492,615 in profits received by plaintiff from government contracts in 1967, $275,000 was excessive. Plaintiff contends that it had no excessive profits, while defendant, the Government, maintains that the $275,000 is correct.

Hicks-Ponder was incorporated in 1920 and maintained its executive offices in El Paso, Texas. It was primarily engaged in the manufacture and sale of men's and boys' casual slacks, work clothes and jeans. Although it had manufactured military trousers for the Government during the Korean war, it normally did not seek government business.

In 1965 the Department of Defense determined that there was a shortage of clothing necessary for the Armed Forces in Southeast Asia. Defense Supply Agency (DSA) personnel then called upon various producers of civilian trousers and asked them to take government contracts for the manufacture of military trousers. Although the Government had the power to require acceptance of rated orders and the manufacturers were so told, in fact DSA never found it necessary to institute legal proceedings or other coercive acts to require acceptance of military clothing orders. DSA attempted to spread the rated orders out in a manner which would not use more than 25 percent of the capacity of any one company. Some manufacturers who had special problems, such as difficulty in converting to government work or the prospect of too substantial a loss of civilian business, were allowed to persuade DSA to

cancel rated orders. Prices and contract terms were arrived at by negotiation after the rated orders were placed. At some time during 1966 sufficient manufacturer interest in obtaining government business was generated as to obviate the need for rated orders and to allow competitive bidding. By 1967 no pants contracts were the product of rated orders.

On January 27, 1966, after discussions during the prior month, DSA issued a rated order to plaintiff for the manufacture of 160,000 pairs of men's cotton sateen fatigue trousers. After commencing work on the first order plaintiff bid competitively on a second government sateen trouser contract, and on May 18, 1966, it received an award for 200,000 additional pairs. DSA also requested plaintiff to either submit a bid or receive a rated order for the manufacture of poplin tropical combat trousers. Shortly thereafter plaintiff bid on such a contract, and on May 16, 1966, it received an award for 35,000 trousers. On June 29, 1966, DSA issued a rated order to the company for an additional 82,500 combat trousers. On January 31, 1967, pursuant to its bid, plaintiff received an award for 210,000 additional pairs with an option for 105,000 more, which the Government in fact exercised. Thereafter, during 1967 and 1968 plaintiff bid on other prime contracts but received no further awards because its bids were too high. However, during 1967 plaintiff obtained four subcontracts for sateen trousers which it completed during the year and carried over into 1968. Plaintiff's shipments of sateen and poplin trousers under government contracts and subcontracts during 1966–68 may be summarized as follows:

	Sateens	*Poplins*	*Total*
1966	289,449	65,028	354,477
1967	525,642	436,039	961,681
1968	105,433	47,659	153,092
Totals	920,524	548,726	1,469,250

Sixty-five and one-half percent of the shipments occurred during 1967, the renegotiable year at issue.

All of the government contracts were essentially identical in form. The Government furnished the fabric (GFM), and the contractor supplied the remainder of the materials

and the cut, make, and trim labor. The contracts were at specified unit prices less the value of the GFM going into each unit. The contractor billed at the total unit price and prompt payment discount in favor of the Government was computed on the total unit price, but the value of GFM was deducted so that plaintiff received only the net.

At the time plaintiff commenced its government work in 1966, all of its plants were running at substantially full capacity. Plaintiff converted a portion of its Del Rio, Texas, plant to production of the sateen fatigue trousers and its entire Yuma, Arizona, plant to production of the poplin combat trousers. Prior to such conversion the Del Rio plant had been engaged in the manufacture of dress jeans, and the Yuma plant had been engaged in the manufacture of deluxe work pants for Sears Roebuck and Co., and casual slacks.

Substantially all of plaintiff's production workers were on a piecework basis, each trained to perform a single operation. For example, a standard commercial jean involved approximately 30 different operations and 30 different operators using approximately 20 different kinds of machines. If the piece rate did not result in an aggregate weekly wage equivalent to the minimum statutory hourly rate, plaintiff made up the difference.

Conversion from civilian production to military production necessitated retraining of the operators and the use of different and additional machines. The sateen trousers involved more than 30 different operations, while the poplin trousers involved 57 different operations. Retraining an operator to achieve the high degree of speed and efficiency which plaintiff demands of its employees for normal production could take from 8 to 16 weeks depending on the complexity of the operation involved. Retraining of entire units operating at successive stages of production to achieve company standards of speed and efficiency could take as long as 26 weeks.

Since during the retraining period the operator might be deprived of a portion of her customary wages through no fault of her own, plaintiff generally guaranteed such operator a wage equal to her previous average hourly

piecework earnings, or at the least the statutory minimum wage.

The sateen trousers were somewhat more complicated to manufacture than were the dress jeans, the average time per dozen of the former requiring 2.6 hours as against 2.0 hours for the latter. The poplin combat trousers were considerably more complex than plaintiff's normal civilian production, requiring 57 different sewing operations per unit and 7.3 hours production time per dozen for the former, as against 40 different sewing operations and 3.7 hours per dozen for the civilian production at the Yuma plant. The Del Rio factory produced an average of 37.15 sateen trousers per operator per 8-hour day, while the Yuma plant produced an average 13.69 poplin trousers per operator per 8-hour day.

In addition to retraining operators for the military production plaintiff was also required to undergo the expense of purchasing or leasing new machinery to be able to perform this work and to idle some of its prior equipment. The new machinery was, however, usable thereafter in civilian work.

Prior to commencing government work as well as during the period of government production Hicks-Ponder was primarily engaged in the contract sales business. In this type of business merchandise was not manufactured for plaintiff's inventory but rather for the needs of its customers, with the contracts being entered into in advance of production. The contract customer selected and paid for the material and then resold it to plaintiff at the same terms, and plaintiff picked up the material at the mill. During the years 1966 through 1968 approximately 80 percent of Hicks-Ponder's total sales were of the contract variety, with the bulk of such sales being made to Sears Roebuck and Co., J. C. Penney & Co., and Montgomery Ward. The government contracts to some degree disrupted such civilian business. However, as the table which follows shows, Hicks-Ponder's civilian business was not substantially adversely affected, since such sales were considerably higher than they had been in 1964 and 1965, and remained at about the same plateau from 1966 through 1968 with

gross profits increasing in successive years from 1965 through 1968.

Hicks-Ponder Co.
Sales and Gross Profits 1964-68 (In Thousands)

	Sales			*Gross Profits*		
Year	*Reneg.*	*Other*	*Total*	*Reneg.*	*Other*	*Total*
1964		$18,148	$18,148		$2,712	$2,712
1965		20,314	20,314		2,607	2,607
1966	$ 715	23,635	24,350	$ 186	2,885	3,017
1967	2,310	23,607	25,917	804*	3,506*	4,310
1968	411	23,619	24,030	82	3,767	3,849

* See note to Chart A, *infra.*

Furthermore, as a percentage breakdown of Hicks-Ponder's sales to its major customers from 1964 through 1968 shows, during 1967, the renegotiable year at issue, not only was it able to keep most of its business with its major customers but it actually increased such business.

	1964	*1965*	*1966*	*1967*	*1968*
Sears Roebuck	54%	55%	56%	52%	51%
J. C. Penney	10	10	9	15	14
Montgomery Ward	13	10	11	8	6
Subtotal for Major Customers	77	75	76	75	71
Government	—	—	3	9	2
Independent	23	25	21	16	27
Total	100%	100%	100%	100%	100%
Computed Sales to Major Customers (In Thousands)	$13,974	$15,235	$18,506	$19,438	$17,061

A. *The Allocation of Profit Sharing and Officers' Bonus Contributions*

In determining whether or not plaintiff's profits on its government business during 1967 were excessive it becomes necessary to ascertain the sales, expenses and profits attributable to the renegotiable business as distinct from plaintiff's other business. The parties have made such an allocation but differ with respect to two items. During 1967 plaintiff maintained a profit-sharing plan for its

employees. The company made annual contributions to the plan equal to 25 percent of its net income above 6 percent of the net worth of the company at the beginning of the taxable year, such contribution not to exceed 15 percent of the aggregate compensation of all participants. It also had a bonus plan for certain key officers, which entitled them to a fixed percentage of the company's profits. For 1967 plaintiff incurred $322,320 of expense with respect to its profit-sharing and officer-bonus plans.

Plaintiff allocated the $322,320 between renegotiable and non-renegotiable business on the basis of the respective profits earned in each segment before deducting the expense in question. Defendant allocated the profit-sharing element of the $322,320 on the same basis as direct-labor costs were allocated, and it divided the officers'-bonus element on the same basis as the general and administrative expenses were divided. Under plaintiff's theory, $76,133 of the $322,320 is properly allocable to renegotiable business, and $246,187 is attributable to non-renegotiable business for 1967. If defendant's position is correct only $52,360 of the $322,320 is properly attributable to renegotiable business and $269,960 is allocated to plaintiff's other business. In short, plaintiff asserts that its renegotiable profits were $23,773 less than what defendant claims they were.

In support of its argument plaintiff relies upon sections 1459.1(b)(1), (5) and (6) of the Renegotiation Board Regulations (32 C.F.R.). These provide in general that the contractor must ordinarily follow the method of accounting used for federal income tax purposes. On its income tax return for 1967, as well as on its audited financial statement for the year, Hicks-Ponder deducted the $322,320 as expenses rather than as a part of the cost of goods sold. This treatment was not disturbed by the Internal Revenue Service in its audits. Plaintiff claims that this supports its theory of allocation, because under plaintiff's method of accounting all additions to direct labor costs and some portion of general and administrative expenses were required to be included in the company's inventory valuation used in computing cost of goods sold. Plaintiff also argues that because Hicks-Ponder only

incurred profit-sharing and officer-bonus expenses to the extent it had profits, in any allocation they should be in proportion to such profits. Defendant argues that on the plaintiff's books and income tax return the officer-bonus and profit-sharing expenses were treated as general and administrative expenses in the nature of additional salary and therefore should be allocated in the same manner as were the other salaries.

It is obvious that neither the books and records, the audit reports, nor the income tax returns are helpful in resolution of this question. None of these had occasion to divide up the items at issue into renegotiable and non-renegotiable expenses. Furthermore, there is no authority in any cited case which decides the issue.

On balance, defendant appears to be correct. The officer-bonus and profit-sharing distributions were expenses. They were deductible on the income tax returns only to the extent that they were part of total wages and salaries, which in the aggregate were reasonable in amount for services actually rendered. Internal Revenue Code, sections 162(a) and 404(a). As salaries, also they had to be necessary and ordinary expenses of the business. Under the circumstances, they should be allocated in the same manner which other salaries and expenses were allocated. To say that such additional salaries should be charged to renegotiable profits because the efforts of the recipients produced the renegotiable profits assumes the conclusion in the case. It may well be that the high renegotiable profits were more the product of the Government's large wartime needs than the efforts of plaintiff's officers and other employees. If plaintiff's position were correct, the larger the excessive profits the more plaintiff would be entitled to charge officers' bonuses and profit sharings against them. Plaintiff would then have a device whereby it could directly reduce excessive profits by distributing them to its officers and other employees in the form of bonuses and profit-sharing distributions.

B. *Reasonableness of Profits with Regard to Sales and Normal Earnings*

Title 50, Appendix, United States Code, section 1213(e) provides that in determining excessive profits there shall be taken into consideration:

> (1) Reasonableness of costs and profits, with particular regard to volume of production, normal earnings, and comparison of war and peacetime products.

Renegotiation Board Regulations, section 1460.10(b)(1) (32 C.F.R.), comments that comparisons should be made with "the contractor's own costs and profits in previous years and with current costs and profits of other contractors, if such information is available." Consideration for comparative purposes is also to be given to—

> (2) * * * profits of the contractor, and of the industry, on products and services not subject to renegotiation, especially in cases in which the renegotiable business involves products or services substantially similar to those not subject to renegotiation. * * *

The products involved in this case are sufficiently similar to those involved in the contractor's normal commercial business, both during the year at issue and in other nearby years, so as to enable rational comparison.

On the basis of the agreed allocations and the foregoing resolution of the one allocation issue in controversy, plaintiff's renegotiable and non-renegotiable income, costs and expenses for the 3 years, 1966–68, may be set forth as shown on Chart A following.

Since defendant offered no evidence challenging plaintiff's costs, it must be assumed that plaintiff's costs were reasonable and that only the reasonableness of its profits are in issue.

Comparison of the results of plaintiff's 1967 operations with those of the 5 prior years and 1 subsequent year shows the following as set forth on Chart B.

The Chart B tabulation shows that for 1967 plaintiff's renegotiable net profit represented 21.34 percent of sales as compared to net profit on its other sales of only 6.32 percent. It also compares with an average net profit of only 4.73 percent on other sales for the prior 5 years, and with

Hicks-Ponder Co.

Income from Renegotiable and Non-Renegotiable Sales—Fiscal Years 1966-68 (In Thousands)

Opinion of Trial Judge

	Total Company			Renegotiables			Other		
	1966	*1967*	*1968*	*1966*	*1967*	*1968*	*1966*	*1967*	*1968*
Sales	$24,350	$25,880	$24,031	$715	$2,273	$411	$23,635	$23,607	$23,619
Material Savings Payments		37			37				
Total Receipts		25,917			2,310				
Materials	13,802	15,206	14,074	88	273	44	13,714	14,933	14,030
Direct Labor	4,088	4,977	5,194	284	765	118	3,804	4,211	5,076
Indirect Mfg. Expenses	3,018	3,410	3,518	211	502	91	2,807	2,908	3,427
Profit Sharing and Officers' Bonuses					(12)*			12*	
Net Change in Finished Stock Inventory	371	(1,986)	(2,604)	(53)	(23)	76	424	(1,964)	(2,680)
Total Cost of Goods Sold	21,279	21,607	20,182	529	1,506	329	20,749	20,101	19,853
Gross Profit	3,071	4,310	3,849	186	804*	82	2,886	3,506*	3,767
Selling and Shipping	803	897	1,129	33	61	12	771	836	1,117
Advertising	148	158	180	11	28	6	137	130	174
General & Administrative	773	757	886	57	136	32	716	622	854
Interest	254	201	283	19	23	9	235	179	274
Profit Sharing and Officers' Bonuses	241	322	289	14	64	5	227	258	284
Adjust Books to Tax Basis	(18)	(11)	(7)				(18)	(11)	(7)
Total Expenses	2,201	2,325	2,760	134	311	64	2,067	2,013	2,696
Net Profit for Reneg.	871	1,986	1,090	52	493	18	819	1,493	1,072
Other Income/Deductions	26	(26)	(61)				26	(26)	(61)
Net Income per Tax Return	$896	$1,960	$1,029	$ 52	$ 493	$ 18	$ 844	$1,467	$1,011

* In determining gross profits on renegotiable and other business for 1967, in the absence of better evidence, 50 percent of the $23,773 increase in renegotiable profits attributable to the reallocation of officers' bonuses and profit sharing expense is allocated to cost of goods sold and gross profits, and the remainder to expenses.

CHART B

Hicks-Ponder Co.
Comparisons of Results of Operations
for Years 1962-68 (In Thousands)

Year	Net Sales	Cost of Goods Sold	Gross Profit	% Gross Profits to Sales	Net Profits	% Net Profits to Sales
1962	$14,583	$12,182	$2,402	16.47	$1,057	7.25
1963	16,349	14,026	2,323	14.21	781	4.78
1964	18,148	15,436	2,712	14.95	887	4.89
1965	20,314	17,283	3,031	14.92	665	3.27
Reneg. 1966	715	529	186	26.01	52	7.27
Other 1966	23,635	20,749	2,886	12.21	819	3.47
Reneg. 1967	2,310	1,506	804	34.81	493	21.34
Other 1967	23,607	20,101	3,506	14.85	1,493	6.32
Reneg. 1968	411	329	82	19.95	18	4.38
Other 1968	23,619	19,853	3,767	15.95	1,072	4.54

an average of 4.93 percent on other sales for the entire 7-year period from 1962 through 1968.

Plaintiff contends that the comparison with the prior years suffers from the fact that it was expanding its business from 1963 through 1965 and thus had various additional expenses which reduced its net profit. However, plaintiff offers no precise or even approximate figures which might show the extent of any distortion for those years, and in any event comparisons of *gross* profits to sales also show a large disparity in favor of government-contract business. On renegotiable sales for 1967 it earned gross profits of 34.81 percent; while on other sales for the same year it grossed only 14.85 percent, for the prior 5 years an average of only 14.55 percent, and for the entire 7 years an average of only 14.80 percent.

Plaintiff also complains that the comparisons are inappropriate because 1967 renegotiable sales prices do not include the value of $1,747,021 in government-furnished materials (GFM), while civilian sales in the comparisons

include the value of the entire materials entering into them. Defendant argues that there is no justification for attributing to plaintiff a return on the cost of materials it failed to lay out or to put at the risk of the business. For factor application purposes effect has been given to plaintiff's contention and to the extent the record permits, the income statements have been reconstructed to enable parallel comparisons of sales and net profits, first, by including GFM in renegotiable sales, and second, by excluding the fabrics from commercial sales. The first is as appears on Chart C following:

CHART C

Hicks-Ponder Co.
Comparisons of Sales and Profits for Years 1962-68
Including GFM in Renegotiable Sales (In Thousands)

Year	*Net Sales*	*Cost of Goods Sold*	*Gross Profit*	*% Gross Profits to Sales*	*Net Profits*	*% Net Profits to Sales*
1962	$14,583	$12,182	$2,402	16.47	$1,057	7.25
1963	16,349	14,026	2,323	14.21	781	4.78
1964	18,148	15,436	2,712	14.95	887	4.89
1965	20,314	17,283	3,031	14.92	665	3.27
Reneg. 1966	1,239	1,053	186	14.98	52	4.20
Other 1966	23,635	20,749	2,886	12.21	819	3.47
Reneg. 1967	4,057	3,253	804	19.82	493	12.14
Other 1967	23,607	20,101	3,506	14.85	1,493	6.32
Reneg. 1968	689	607	82	11.88	18	2.68
Other 1968	23,619	19,853	3,767	15.95	1,072	4.54

It is apparent that even with the value of GFM included in its 1967 renegotiable sales plaintiff's profits, equivalent to 12.14 percent of reconstructed sales, were at a rate almost twice as high as the 6.32 percent rate of profit on its other sales for the same year, and about 2½ times the prior 5-year average rate of 4.73 percent on other sales and the average rate on other sales for the entire 7-year period of 4.93 percent. Reflecting the probability that such renegotiable profits were not merely a matter of lower selling,

advertising and general and administrative expense on government business, but of plain excessive profits on manufacturing in the quantities sold to the Government, is the fact that *gross* profits on renegotiable business for 1967 are almost 5 percent higher than on other business for the same year. The 19.82 percent may also be compared with the average of gross profits on other business for the prior 5 years of 14.55 percent, and for the entire 8 years of 14.79 percent.

On the present record reconstruction of the comparative income statements to exclude the value of government-furnished materials from renegotiable sales and their equivalent from other sales can only be done with respect to the years 1966, 1967 and 1968. Furthermore, even on renegotiable sales the Government furnished the cloth but plaintiff supplied some of the materials (probably buttons, thread, pockets, etc.). The ratio is 86.29 percent of the material supplied by the Government to 13.71 percent by the plaintiff for the 3-year period. Therefore, 86.29 percent of material costs have been excluded from other sales.[1] The comparison reflects the following:

CHART D
Hicks-Ponder Co.
Comparison of Net Profits and Sales for Years 1966-68
Excluding GFM from Renegotiable Sales and Equivalent
Materials from Commercial Sales ($ In Thousands)

	Renegotiable			*Other*		
	1966	*1967*	*1968*	*1966*	*1967*	*1968*
Sales Minus Materials	$715	$2,310	$411	$11,551	$11,869	$12,953
Net Profit for Reneg.	52	493	18	819	1,493	1,072
% Net Profit to Sales	7.27%	21.34%	4.38%	7.09%	12.58%	7.83%

From the foregoing it is clear that even after value of GFM and comparable materials are excluded from both renegotiable and commercial sales for the 3-year period, 1966–68, plaintiff's reconstructed renegotiable net profits

[1] The material portion of the "Net Change in Finished Stock Inventory" were computed in the ratio of material cost to total cost of goods sold each year.

for 1967, equivalent to 21.34 percent of sales, were at a rate 70 percent higher than the 12.58 percent rate of profit on commercial sales for the same year and more than twice the average rate of 9.3 percent on commercial sales for the 3-year period.

From all of the foregoing comparisons it is apparent that plaintiff's rate of profit on sales to and for the use of the Government in 1967 was far in excess of its normal rate of profit on sales to others, both during the same year and in other nearby years.

The record is not adequate to make equally detailed comparisons with the profits of plaintiff's competitors.

C. *Plaintiff's Net Worth and Capital*

Section 1213(e) also requires that there be taken into consideration—

> (2) The net worth, with particular regard to the amount and source of public and private capital employed.

Section 1460.11(a)(4) of the regulations comments that:

> The relationship of profit realized on renegotiable business to the capital and net worth employed in renegotiable business will be used as one of the considerations in the final determination of what constitutes excessive profits. * * *

Plaintiff offered no evidence on this factor as a part of its prima facie case. However, defendant submitted in evidence a comparison of returns on capital and stock equity (or net worth) for 1967 for renegotiable and non-renegotiable business.

The initial problem was to make a fair allocation of the total capital and equity used in producing the 1967 income in each type of business. Defendant's FBI-accountant witness used various alternative methods for making such an allocation. His first method was to base the allocation on the comparative cost of goods sold for renegotiable business with total cost of goods sold, including GFM in both. This produced a 14 percent allocation to renegotiable business. An alternative comparison without GFM came out to a 7 percent allocation of capital for renegotiable

business. The second method was to compare renegotiable direct labor with total labor. This showed a 15 percent allocation for capital used in renegotiable business. The third method compared direct labor for the 3 years, 1966–68, for renegotiable business with total direct labor for the same years, resulting in an 8 percent allocation. The fourth method derived its allocation from the proportion which 1967 renegotiable sales bore to total sales, both without GFM. From this there was derived a 9 percent allocation. The fifth method compared renegotiable sales for the 3 years with total sales, producing a 5 percent allocation of capital used for renegotiable business. The sixth method compared specific assets used in production for renegotiable business with total assets. From this the witness derived a 9 percent allocation. Although the witness preferred method three, which produces an 8 percent allocation of capital used in renegotiable business to total capital, he concluded that an average of the various methods should be used. This resulted in an allocation of 10 percent of the capital and equity to renegotiable business and 90 percent to non-renegotiable business for the fiscal year 1967.

Plaintiff proposed no particular figure for allocation of capital and equity to renegotiable business and to non-renegotiable business.

As of the beginning of plaintiff's fiscal year 1967 plaintiff's stockholder equity was $5,017,164 and capital employed in the business (total assets, or stockholder equity plus debt) was $10,407,322, including therein $2,839,995 in current liabilities.

Applying allocation of 15 percent to capital and equity used in plaintiff's renegotiable business and 85 percent used in its other business, the dollar allocations as of the beginning of 1967 are as follows:

	(In Thousands)		
	Total	*Renegotiable*	*Non-Renegotiable*
Capital Employed	$10,407	$1,561	$8,846
Stock Equity Employed	5,017	753	4,265

Utilizing 1967 renegotiable profits of $492,615 and other profits of $1,492,960, on the basis of a 15 percent allocation plaintiff's returns on beginning capital and equity for 1967 were:

	Renegotiable	*Non-Renegotiable*
Return on Capital Employed	32%	17%
Return on Equity Employed	65%	35%

Using an allocation of 10 percent to capital and equity used in plaintiff's renegotiable business and 90 percent used in its other business, the dollar allocations as of the beginning of 1967 are as follows:

	(In Thousands)		
	Total	*Renegotiable*	*Non-Renegotiable*
Capital Employed	$10,407	$1,041	$9,367
Stock Equity Employed	5,017	502	4,515

Utilizing 1967 renegotiable profits of $492,615 and other profits of $1,492,960, on the basis of a 10 percent allocation, plaintiff's returns on beginning capital and equity for 1967 were:

	Renegotiable	*Non-Renegotiable*
Return on Capital Employed	47%	16%
Return on Equity Employed	98%	33%

Plaintiff also failed to offer any evidence of its own to challenge the comparative returns on capital and equity computed by defendant's witness, nor does it claim that the government-furnished material should be included in plaintiff's capital. It does claim that it had to idle old machines in which it had previously invested, but it furnished no financial data on the extent to which they were not yet fully depreciated.

Defendant urges that comparison may also be made with the return on capital and equity for 1962, but standing alone 1962 is not sufficiently close to be useful; and neither

party has explained why it failed to offer evidence with respect to capital and equity for the intervening years.

D. *Extent of Risk Assumed*

Section 1213(e) of the statute requires that consideration be given to—

> (3) Extent of risk assumed, including the risk incident to reasonable pricing policies.

There is no doubt that in initially undertaking the military work at the Government's request plaintiff incurred some financial risks. Its production employees were not expert seamstresses but largely unskilled workers whom it had itself trained, each to perform a single operation on a single machine. The military trousers were sufficiently different from their regular work so that it was necessary to retrain them, and particularly with respect to the more complex poplin combat trousers which took about twice as long to make as the work pants displaced at the Yuma plant. Plaintiff also had to buy or lease new machines to meet the specification in the government contracts, although plaintiff had no guaranty as to the extent of the government business it might receive and did not know whether the cost of the machines could be fully amortized out of government business. However, to a large extent such risks were compensated by higher 1966 prices for which there was no renegotiation, and the machines were useful in later civilian work. In any event, plaintiff requests no specific allowance for these elements.

Plaintiff further claims it had to displace its production of civilian goods for its regular customers in two of its six plants; but this could not have been too serious since it apparently was able to expand the capacity of its other plants to enable sale of about the same dollar value of merchandise to civilian customers in 1967 as in the prior year with an even greater dollar amount going to its major customers than in 1965 and 1966.

Specifically at trial and in its brief plaintiff placed its greatest emphasis on its claims that in the determination of whether or not it had excessive profits on renegotiable business for 1967, there should be reductions for additional

expenses it incurred in 1968 in converting back two of its plants to civilian business and for profits it lost in failing to obtain seasonal civilian business promptly as a result of its government work.

Section 1213(f) of the statute prohibits carrybacks of cost from another year in computing excessive profits, but this does not necessarily mean that related items of cost in a succeeding year which are triggered by the renegotiable year's business may not be considered as a necessary or probable risk item for which a contractor should receive an allowance.

The Renegotiation Board Regulations on this subject follow the same rationale. Section 1459.10 (32 C.F.R.) provides:

> § 1459.10 Costs incident to discontinuance of a renegotiable operation.
>
> * * * * *
>
> (e) *Reconversion.* Costs of establishing or reestablishing commercial operations are not costs of performing renegotiable business and are not allocable thereto as costs incident to discontinuance of a renegotiable operation or otherwise. * * *

On the other hand, section 1460.12 states:

> § 1460.12 Extent of risk assumed.
>
> * * * * *
>
> (b) *Comment.* (1) The risks to be considered include but are not limited to risks incident to close pricing policies. * * * In some cases a substantial degree of risk will be found in the temporary sacrifice of civilian markets to competitors, in order to accept more defense orders, or in the certainty of heavy reconversion expenses at the end of the emergency. * * * The Board will give special consideration to evidence showing risks through actual realization of losses incurred by the contractor in performing contracts in other years similar to the contracts undergoing renegotiation, * * *.

And see also *A.C. Ball Co.* v. *United States*, 209 Ct. Cl. 223, 531 F. 2d 993 (1976), and Nichols, *Equalizing Profit and Loss in Renegotiation*, 45 VA. L. REV. 41, 59 (1959).

It is concluded from the evidence that the cost of reconversion to plaintiff's normal peacetime business posed

a recognizable risk which should be considered in fixing plaintiff's excessive profits for 1967; however, the amount involved is nowhere near the aggregate figure plaintiff claims.

Plaintiff asserts that the cost of reconverting its Yuma, Arizona, plant to civilian production was $64,117, consisting of excess make-up wages in the sum of $29,144 and lost overhead absorption of $34,973, and that the cost of reconverting its Del Rio, Texas, plant to civilian production was $23,723, for a total reconversion cost of $87,840, all of which was incurred in fiscal 1968.

As previously noted, the workers at plaintiff's plants were paid by piecework and "make-up" was paid in addition to the regular rate to reach the statutory hourly minimum wage, or in some instances a guaranteed wage approximating 15 percent in excess of minimum wages, where the short-fall was not due to the workers' fault but because of slowdowns due to changed operations and consequent need for retraining. Plaintiff's officers testified without contradiction that 6 months was an average period for an entire unit of production to achieve normal maximum operating efficiency in civilian manufacture after termination of military production. Government-contract work was completed by the end of January 1968 and, therefore, the excess make-up was paid during the 6 months thereafter.

Plaintiff's treasurer-controller testified that during November and December 1967 and January 1968 plaintiff had reached a high level of productivity in its Yuma plant so that the amount it had to pay out as make-up wages was only 10 percent of its productive direct-labor costs; however, by July 1968, "During the six-month period, the accumulative make-up rate rose 6.67 percent above the sustained productivity or the sustained level at the time we discontinued the government work." Applying the 6.67 percent increase to the direct-labor costs of $436,935 at the Yuma plant for the period February 1 through July 31, 1968, he computed that the Yuma plant had increased make-up costs of $29,144 due to the reconversion from military to civilian production. To this sum plaintiff and its witness added $34,973 in unrecoverable overhead expense

ordinarily allocated to direct-labor costs under plaintiff's method of accounting[2] but which was not recoverable in this instance because such labor costs were unproductive, making total Yuma reconversion costs of $64,117. Since Del Rio's 1967 direct labor was 37 percent of Yuma's, he estimated Del Rio's reconversion costs at 37 percent of Yuma's, or $23,723. Therefore, plaintiff claims, total fiscal 1968 reconversion costs at both plants were $87,840.

Two major questions are raised by plaintiff's reasoning which affect the validity of its results. First, if plaintiff is claiming that its profits on government contracts are not excessive because they do not reflect the excess costs it had to incur in order to reconvert to civilian work in the following year, plaintiff should properly compare its productivity in such renewed civilian work with that in prior civilian work rather than with its productivity in government work. For civilian production, plaintiff's norm for make-up pay was 16 percent of its direct labor rather than 10 percent, and plaintiff used the 16-percent figure in its budget for fiscal 1968. We are not told why the greater efficiency for government work. It may have been due to a more standardized product without style or material changes, to the absence of patterns to be matched, to the use of new more efficient machinery bought to perform the government work, or to a smaller labor turnover for steady work on large contracts. In any event, whatever the reason, it would be more valid to compare the 16.67 percent accumulative make-up rate for July 1968 with the 16 percent norm rather than with the 10 percent achieved on military production. Indeed, plaintiff's treasurer-controller conceded that such a revised comparison might be "equitable" and that had reconversion costs been computed by comparing the average make-up rates for the 6 months from February through June 1968 with the 16 percent norm rather than with the 10 percent, there would have been a reduction in conversion costs claimed of about $30,000 for the Yuma plant and $13,000 for Del Rio.

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[2] Plaintiff's overhead rate during the 6 months beginning February 1, 1968, was 120 percent of direct labor.

More important, plaintiff and its witness ignore the impact of the increase in the statutory minimum wage from $1.40 to $1.60 per hour, effective February 1, 1968. *See* 29 U.S.C. § 206(a)(1) (1970) and Pub. L. 89–601 § 602, 80 Stat. 830 (1966). The Hicks-Ponder 1968 and 1969 proxy statements incident to its merger with Blue Bell noted that this amendment to the law resulted in an adverse effect on earnings for the 6 months ended April 30, 1968 and for all of 1968 because of increased wage levels both for those paid minimum wages and those paid in excess thereof. It is impossible to tell from the record the extent to which the increase in make-up costs was due to the reconversion from military to civilian production rather than to the 14 percent increase in minimum wage levels at the time of the changeover.

While not conceding the pertinency of plaintiff's reconversion costs, defendant's witness, H. Thomas Kirsche, an FBI accountant, recomputed them to be $14,644 (after correction from $14,359 due to mathematical error). Kirsche compared plaintiff's Yuma plant make-up rate for entire fiscal year 1968, 15.72 percent of direct labor, with the entire 1967 figure, 14.46 percent. He then multiplied half of the 1968 direct labor, $306,000, by the 1.26 percent difference to arrive at excess make-up of $3,856 for the first 6 months of 1968. The other element of reconversion cost was unabsorbed overhead. He found that on a pro rata basis Yuma's direct labor was $8,782 less than budgeted. Since the company computed overhead at 120 percent of direct labor, the unabsorbed overhead was 120 percent of $8,782, or $10,538. This resulted in total unabsorbed make-up and overhead due to reconversion of $14,394. Since Del Rio's 1968 direct labor on government work was 19 percent of Yuma's, under his theory Del Rio's unabsorbed make-up and overhead was 19 percent of $14,394, or $2,735. Thus, the total was $17,029. Since in his opinion plaintiff's 1967 renegotiable business was 86 percent of its total government business for the 3 years, his allocation of reconversion cost to 1967 was 86 percent of the $17,029, or $14,644.

Defendant's computations also contain several errors: First, defendant derives its post-government work make-up rate from plaintiff's average experience for the entire 1968

fiscal year. This disregards the facts that during the first 3 months (November 1967-January 1968) the Yuma plant was still engaged in government-contract work and operating at maximum efficiency, and during the last 3 months plaintiff had already completed its reconversion and attained its efficiency norm. Second, defendant errs in deriving its Del Rio reconversion cost from comparison of 1968 renegotiable contract-labor costs of Del Rio with those of Yuma, since it disregards the fact that Del Rio only operated on 1968 renegotiable contracts for 6 weeks while Yuma had 3 months. Had Del Rio not had any renegotiable work in 1968, defendant's method would have resulted in zero reconversion cost for Del Rio for that year. Next, the proper allocation of any reconversion cost to 1967 government contract work should be 65.5 percent rather than 86 percent. (See finding 26.) Finally, defendant likewise fails to take any cognizance of the February 1, 1968 increase in minimum wage as a variable affecting make-up expense for other than reconversion reasons.

Plaintiff also claims that as a result of being unable to regain its civilian-contract position until after the end of fiscal 1968, plaintiff failed to absorb $128,719 in overhead expenses which it continued to incur and which would have been absorbed if production had continued at prior budgeted levels. In explanation of this claim plaintiff asserts that when government work terminated at its Del Rio plant in December 1967 and at its Yuma plant at the end of January 1968, it was unable to replace it with civilian business for several months during 1968 primarily because it was between seasons for contracts for manufacture of merchandise for its principal customers, Sears Roebuck, Montgomery Ward and J.C. Penney. New contracts were not obtainable until the fall of 1968, such customers' needs having been satisfied by contracts let to other manufacturers in September-November 1967, when plaintiff was unavailable due to its government business.

Plaintiff computed the $128,719 in the following manner: The Del Rio plant had been producing 175 dozen sateen military dress trousers per day for the Government. When that work terminated, plaintiff was unable to replace any of it through March; it was unable to replace 75 dozen per

day from April through August; and it was still short 50 dozen per day through October. The missing production would have cost it $107,266 in direct labor for the year. Since plaintiff's budget for fiscal 1968 allocated overhead to the cost of its merchandise at a rate equivalent to 120 percent of its direct labor, the unanticipated termination of government work and consequent inability to replace it fully until after fiscal 1968 meant that $128,719 of continuing overhead expense (120 percent of $107,266) became unrecoverable.

While plaintiff's method for allocating overhead expense may be correct as a matter of accounting, it does not necessarily follow that plaintiff's 1968 overhead expenses were properly attributable to its 1967 government work. First, even if coincident with the termination of its government work plaintiff had been able to restore the equivalent of its civilian production immediately, there is no evidence that it would have reached 175 dozen trousers for every working day or the equivalent amount of productive labor as in the performance of military contracts. Plaintiff offered no evidence of its direct labor at the Del Rio plant *just before* it undertook the government work. Civilian trousers involve varying patterns and styles while the sateen military dress trousers were of a single type, and the record reflects that plaintiff's employees were in fact substantially more efficient in government work (10 percent make-up pay versus 16 percent).

Second, there is no evidence that had plaintiff sought contracts in September-November 1967 for production of civilian trousers at Del Rio in 1968, it would have been able to obtain sufficient additional orders to replace fully its government work and to keep its employees occupied at the same full capacity as in the government work. Comparison of year-to-year sales reflects that plaintiff's military production did not oust plaintiff's civilian business but was in addition thereto, since plaintiff's non-renegotiable business increased from 1965 to 1966 and remained about the same from 1966 through 1968.[3]

[3] Indeed, even for the 6 months ended April 30, 1968, Hicks-Ponder's aggregate sales despite reduced government business actually increased from the prior year. Six-month sales were $9,264,499. For the 6-month period ended April 30, 1967, its

The assumptions plaintiff's counsel makes in its argument must also be appraised in the light of the following reports of business conditions in its proxy statements of September 1968 and February 1969:

> During 1967 the apparel industry in general experienced depressed sales brought about by the pressure for reduced inventories at the wholesale and retail levels. This general condition contributed to Blue Bell's sales being below expectations, resulting in depressed profit margins, higher inventory financing requirements and higher selling and general and administrative expenses per dollar of sales volume. This general condition continued to affect Blue Bell's profits through the first quarter of the 1968 fiscal year.

and

> The field in which Hicks-Ponder is engaged is highly competitive. Hicks-Ponder competes with a number of manufacturers, some of which are considerably larger, but no single manufacturer has more than a small percentage of the total apparel market.

The Defense Supply Agency's procurement specialist for the industry testified without contradiction that extensive government orders for military trousers caused an expansion of industry capacity, so that when government orders slackened at the end of 1967 civilian demand was inadequate to keep the manufacturers fully occupied, with the result that they attempted to underbid each other on the limited government business still available. This is corroborated by the evidence of plaintiff's own efforts to obtain additional government orders on at least six occasions during 1967 and 1968, which were unsuccessful because its bids were undercut by its competitors.

Third, as far as the record shows, plaintiff's failure to obtain sufficient and timely civilian work to replace fully its government business immediately upon the completion thereof may have been due to plaintiff's own misjudgment rather than to the fact of the government work or of its termination. As noted plaintiff's voluntary bids for additional government contracts on six occasions during 1967

sales were $9,224,078. However, both its gross and net profits declined; its gross profits for the same periods were $1,818,869 and $1,628,720, respectively; and its net earnings before income taxes were $8,354,426 and $8,903,416, respectively.

and 1968 were too high. At least three of these, for the kind of sateen trousers manufactured at Del Rio, were submitted and rejected well prior to the fall of 1967, when plaintiff still had the opportunity to solicit orders from its mail order and department store customers for manufacture from February 1968 on. Plaintiff does not allege that it was unaware as to when its government orders would be completed, nor does the record show that anyone misled it into relying erroneously to its detriment on forthcoming additional government work. It continued to bid on government work because it found it more profitable. Under the circumstances, any unrecouped overhead expense loss which plaintiff may have suffered through lack of replacement work for the military trousers because its bids were too high, or for any other reason, may not properly be charged to the Government.

Plaintiff further claims a loss in 1968 profits of $94,000 as a direct consequence of the plaintiff having been engaged in government business from fiscal 1966 through 1968. Its treasurer-controller estimated that during fiscal 1968 the Del Rio plant could have manufactured 250,800 additional civilian trousers having an average sales price of $3 per unit, or $752,400, and that an assumed 6 percent profit rate before taxes would have returned $44,144 in profits. He also estimated $50,000 in lost 1968 profits from the unreplaced government business at the Yuma plant. Although Yuma substituted for its government business work that would have been manufactured at its El Paso plant, as a consequence thereof plaintiff claims lost profits at El Paso because the latter then took on a new type of garment in lieu of what it transferred to Yuma with a resulting increased $156,000 variance in labor costs over budget and consequent similar reduction in profits. Plaintiff's controller-treasurer without further explanation attributed $50,000 of this reduction to the change. For reasons already discussed with respect to the lost overhead claim, this is too speculative to warrant a finding in support of plaintiff's claim.

E. *Contribution to the Defense Effort*

Section 1213(e) further states that consideration should be given to the—

> (4) Nature and extent of contribution to the defense effort, including inventive and developmental contribution and cooperation with the Government and other contractors in supplying technical assistance.

Regulations section 1460.13 comments that this contemplates more than mere satisfactory performance of a kind common to defense contractors generally. It allows giving of credit for superior performance, completion of work ahead of schedule, unusual overcoming of difficulties and similar exceptional service. Plaintiff concedes that it did not make "any innovative or developmental contribution" but urges that it deserves some favorable consideration for its timely delivery of well-manufactured garments.

It has been found that the quality of Hicks-Ponder's trousers was good, its rejection rate was extremely minute, all of its deliveries were on schedule, its performance record was rated as "Excellent" and it was issued a "Quality Award" by the Government. This is given consideration under the factors to which it properly belongs.

F. *Character of Business*

Section 1213(e) also requires that there be taken into consideration the—

> (5) Character of business, including source and nature of materials, complexity of manufacturing technique, character and extent of subcontracting, and rate of turnover.

Plaintiff claims it deserves favorable consideration under this factor "because of the extreme complexity of the poplin combat trouser which is one of the most difficult garments to manufacture in the garment industry", and also because it performed all production work without subcontracting any of it.

With respect to the former, the effect of such complexity as may exist in the construction of the combat trousers is reflected in the additional time and labor cost involved in

its manufacture. To the extent additional training was involved it was also a part of the cost for which it was compensated. The record does not permit exploration of the effect, if any, which the added complexity may have had on value added. *See Butkin Precision Mfg. Co.* v. *United States*, 211 Ct. Cl. at 129, 544 F. 2d at 509–10. The evidence does not indicate that the complexity was other than in the greater detail and reinforcement of a familiar product and material. There is no evidence that the Government's specifications were not adequate for anyone in the pants business to follow with proper equipment, or that plaintiff was only told of the end product desired and was required to exercise its own ingenuity and inventiveness to accomplish it. In comparing the renegotiable business with the commercial business, the absence of retraining and conversion problems in the latter is to be noted.

G. *Efficiency of the Contractor*

Section 1213(e) of the statute states that:

> * * * [F]avorable recognition must be given to the efficiency of the contractor or subcontractor, with particular regard to attainment of quantity and quality production, reduction of costs, and economy in the use of materials, facilities, and manpower; * * *.

Included in the plaintiff's receipts from government business was $36,747 in material-savings payments. It is not clear whether this designation is that of the plaintiff, its accountants, or the contracting parties. The government contracts are not in evidence and the two subcontracts which are in evidence do not use the term. In any event, plaintiff urges that this is direct compensation for efficiency and that, therefore, no part of it should be recoverable as excessive profits.

The testimony of DSA's clothing procurement specialist was that since the contract prices were unit prices it was necessary to allocate to each pair of trousers an estimated 2.2 running yards of fabric. In one or more instances the cost of the fabric contributed by the Government was fixed at $1.33 per unit, which represented the 2.2 yards at 60 cents per yard. The contractor was entitled to receive $2.76 per unit less the $1.33. If the contractor used less than the

2.2 yards it was entitled to retain the excess materials, but if the contractor used more, it came out of its share of the $2.76. The procurement specialist also testified that the number of yards required was an administrative determination rather than a precise figure, to enable Government accounting for the fabric, and it was up to the contractor to determine from his own experience how much material was required and set his bid or negotiated price to reflect the actual fabric he would require. This is confirmed by a teletype from DSA to plaintiff in December 1965 in which the Government offered to pay to plaintiff $2.41 per unit for manufacture of the sateen trousers less $1.33 for the GFM, but added that "In the event you determine that the sum of $1.33 is not accurate in relation to your material usage, indicate any recommended adjustment and the reasons therefor."

The $36,747 which plaintiff received as a result of using less fabric than the contract estimates represented 2 percent of the $1,747,021 in government-furnished material for the year 1967. It is hardly likely that the Government would have used in the contracts unit material estimates which would not have permitted as little as 2 percent variations on either side by individual manufacturers. Without such tolerances some manufacturers making up the average might have run short of materials. There is no evidence in the record indicating the comparative degree to which other manufacturers profited from materials savings, nor the degree to which materials estimates normally contemplated such savings. Accordingly, it is not reasonably possible to conclude that the $36,747 represented specific compensation for efficiency rather than merely a part of the overall method of payment.

Plaintiff also urges that favorable recognition for efficiency should be given for the facts that the quality of the trousers was good and the rejections minute and that deliveries were made on schedule. Plaintiff also notes that DSA representatives determined that Hicks-Ponder was economical in the use of materials, facilities and manpower, and made very effective use of such facilities. Plaintiff further contends that the company's production per operator was above the production norm for other

contractors, but there is no admissible evidence to support such a finding. If efficiency can be measured at all in reduced unit prices it appears that plaintiff's prices were only midway in the range of bid prices for similar products during 1966 and the early part of 1967, and that it was unable to bring its costs down sufficiently to obtain any government contracts thereafter although it bid on a number of solicitations.

As already noted, plaintiff is entitled to favorable consideration for the quality of its performance and its compliance with delivery requirements.

FINDINGS OF FACT

1. Plaintiff, Blue Bell, Inc., is a corporation organized under the laws of Delaware and has its principal offices in Greensboro, North Carolina.

2. On March 31, 1969, Blue Bell acquired all of the assets and liabilities of the Hicks-Ponder Company, a Texas corporation, in a statutory merger.

3. Hicks-Ponder was incorporated in 1920 and maintained its executive offices in El Paso, Texas.

4. Prior to its acquisition by Blue Bell, Hicks-Ponder was primarily engaged in the design, manufacture and distribution of men's and boys' casual slacks, work clothes and jeans.

5. Hicks-Ponder maintained its financial records on the accrual method of accounting using a fiscal year ending on October 31.

6. From early 1950 during the Korean War until its fiscal year beginning November 1, 1965, Hicks-Ponder did not engage in any government business.

7. Hicks-Ponder normally did not seek government contracts because the garments required by the Government were different from those made by the company and the additional cost of adapting its production unit to the different products would have made its prices noncompetitive with those of manufacturers who normally bid on government business.

8. In 1965, the Director of Installation and Logistics of the Department of Defense made a determination that there existed an emergency because of the shortage of certain items in the clothing supply due to the military build-up in Southeast Asia.

9. Personnel from the Defense Supply Agency called upon various producers of civilian trousers including

plaintiff and asked them to take government contracts. If they agreed, rated orders would be issued.

10. The guidelines for issuing rated orders were:

(a) Producers were not required to take any more orders than would use 25 percent of the capacity of any one plant.

(b) Business would be done with a producer on the same basis as he conducted commercial business.

(c) The specifications would be adjusted to meet whatever requirement a producer had so long as he did not alter the serviceability of the garment.

(d) A telegram was sent to the producer notifying him that he had been given a rated order, and he was then invited to come to Philadelphia to discuss quantity and other terms of the order.

(e) Producers were told that rated orders could be required under the Defense Production Act but that, if they had valid reasons for refusing them, the Government would listen.

11. Rated orders were canceled for such reasons as that the expense of converting to government work was too great or that the loss of civilian business had too great an impact.

12. Legal proceedings were never in fact instituted against any contractor who refused a rated order. Persuasion and the possibility of the Government preemptively purchasing the necessary textiles from the mills were enough to accomplish the Defense Department's ends.

13. The cost of converting to government work from civilian work was usually included in the negotiations to arrive at a price on a rated order.

14. On January 27, 1966, the Defense Supply Agency, an agency of the United States Government, issued a rated order to Hicks-Ponder for the manufacture of 160,000 pairs of men's cotton sateen fatigue trousers required for the Vietnam war effort. The order was given contract number DSA–100–2162.

15. The rated order was originally communicated to Hicks-Ponder by a telegram dated December 24, 1965, which stated that DSA was issuing "a direct order with a priority rating" for the manufacture and delivery of the trousers in question.

16. After commencing work on its first sateen trouser contract, Hicks-Ponder bid on a second government sateen trouser contract (DSA 100–4275), and received an award for 200,000 pairs on May 18, 1966.

17. Shortly after March of 1966, a representative of DSA had called upon Hicks-Ponder to request that the company

undertake production of poplin combat trousers for the Government.

18. Hicks-Ponder was advised to submit a bid or receive a rated order for production of the combat trousers.

19. Hicks-Ponder shortly thereafter bid on a contract for the manufacture of men's poplin tropical combat trousers and, on May 16, 1966, received an award for 35,000 pairs. The contract number was DSA 100–4194.

20. The Government determined that a greater supply of combat trousers was needed and should be provided by Hicks-Ponder. Accordingly, DSA issued a rated order to the company on June 29, 1966, for the production of an additional 82,500 pairs. The contract number was DSA 100–5014.

21. Hicks-Ponder completed its obligations under contracts DSA 100–2162 and DSA 100–4194 during its fiscal year ending October 31, 1966. Contracts DSA 100–4275 and DSA 100–5014 were completed in the following fiscal year.

22. Although Hicks-Ponder initially did not want to take government business, once the company had incurred the conversion costs for manufacturing such products it did seek additional government business.

23. Hicks-Ponder bid on a subsequent government combat trouser contract and on January 31, 1967, received an award for 210,000 pairs. The Government also reserved an option to have Hicks-Ponder manufacture an additional 105,000 pairs which it exercised. The contract, DSA 100–67–C–3395, was partially completed during fiscal 1967 and finished in the following fiscal year.

24. During its fiscal years 1966, 1967 and 1968, Hicks-Ponder bid on other prime contracts, but received no further awards.

25. During its fiscal year ending October 31, 1967, Hicks-Ponder received four subcontracts for government trouser production. Three were completed in that year and one carried over into fiscal 1968.

26. During the fiscal years 1966, 1967 and 1968 Hicks-Ponder shipped sateen and poplin trousers under government contracts and subcontracts as follows:

	Sateens	*Poplins*	*Total*
1966	289,449	65,028	354,477
1967	525,642	436,039	961,681
1968	105,433	47,659	153,092
Totals	920,524	548,726	1,469,250

Of the total units shipped during the 3-fiscal-year periods, 65.5 percent of the units were shipped in fiscal 1967.

27. Hicks-Ponder has had no government business since its 1968 fiscal year.

28. The government contracts under which Hicks-Ponder operated were essentially identical in format. All were firm fixed-price contracts and each specified a total unit price consisting of the sum of a cut, make and trim price (including materials other than the fabric) and a government-furnished material price for the fabric. Any prompt payment discount was computed on the total unit price. The contractor was required to bill at the total unit price, but, since the fabric was furnished by the Government, the value of the furnished material offset the material portion of the total unit price and Hicks-Ponder would receive only the cut, make and trim price less any discount.

29. Each contract contained an estimated value for the GFM per pair of trousers, computed by multiplying the Government's yardage cost by approximately 2.2 yards per unit. In one contract such material had cost the Government 60 cents per yard and the unit value was stated to be $1.33. Such GFM value was not at the same fixed price for all contracts. In a rated order or other negotiated price contract it was subject to negotiation and varied with the contractor's experience as to its individual use of cloth per unit. In advertised contracts the bidder was required to reflect its individual material need variation in its bid. Once the unit GFM value was stated in the contract, greater use of yardage resulted in additional deduction from the aggregate price for GFM and lesser use resulted in reduced deduction or increased net proceeds. Through lesser material use than estimated, for the year 1967 plaintiff received $36,747 more than the aggregate cut, make and trim prices for the year. This was approximately 2 percent of the $1,747,021 value of the GFM for such year.

30. Each government contract under which Hicks-Ponder performed during its fiscal years 1966 through 1968 contained a provision which was identical to or the equivalent of the following:

> "The contractor assumes the risk of and is responsible for any loss or damage to Government material regardless of the cause, from the time the material is delivered to the carrier at the originating location to the time it is redelivered by the contractor to the Government. It shall be the contractor's responsibility to obtain such insurance, as he may deem necessary, at his own expense."

31. At the time Hicks-Ponder commenced work on government contracts in its fiscal year 1966, all of the

company's plants were running at substantially full capacity.

32. In order to fulfill its government contracts, Hicks-Ponder converted a portion of its Del Rio, Texas, plant to the production of sateen trousers and its entire Yuma, Arizona, plant to the production of the poplin combat trousers.

33. Immediately prior to the conversion from civilian production to government production, the entire Del Rio plant had been engaged in the manufacture of dress jeans, while the Yuma plant had been engaged in the manufacture of both deluxe work pants for Sears Roebuck and Co., and casual slacks.

34. Conversion from civilian production to government production at the Del Rio plant involved changes in operations which required retraining of operators.

35. Conversion to government production at Yuma necessitated changes in new operations requiring rearrangement of plant production lines and retraining of the operators in different sewing operations.

36. In Hicks-Ponder's business, a machine operator was not trained to be a seamstress who could perform all of the operations in sewing a garment but, rather, was trained to perform a single operation. A standard commercial jean, for instance, involved approximately 30 different operations and 30 different operators using approximately 20 different kinds of machines.

37. Manufacture of sateen trousers for the Government involved more than 30 different operations, while manufacture of the poplin trousers involved 57 different operations.

38. Training an operator who can already perform one sewing operation to perform a different operation at the high degree of speed and efficiency which plaintiff demands of its employees for its normal production can take as much as 8 to 16 weeks, depending on the complexity of the operation involved.

39. Since all of the operators at successive stages of production cannot be trained to company standards of speed and efficiency until the work is in process, the cumulative training of all the operators in a sewing unit to produce a new product at maximum efficiency may take as long as 26 weeks (or 6 months).

40. During its fiscal year 1966, Hicks-Ponder incurred costs of $54,115 at its Del Rio plant and $79,425 at its Yuma plant to convert from civilian to government production, and such conversion costs resulted in higher contract prices in 1966 than in 1967.

41. The 1966 conversion costs on the books were attributable to excess make-up and the aliquot overhead

attributed thereto under plaintiff's method of cost accounting.

42. All Hicks-Ponder operators were on piecework, and when an operator retrained for a new job she could not earn her customary aggregate wages at the piecework rate until the new job was mastered.

43. Since during the retraining period the operator would be deprived of a portion of her customary wages through no fault of her own, Hicks-Ponder generally guaranteed the operator a wage equal to her previous average hourly piecework earnings.

44. In any event, the operators had to be paid at least the minimum wage.

45. The difference between the piece rate wage earned on the new job and the greater guaranteed wage or minimum wage actually paid equalled Hicks-Ponder's make-up cost.

46. The excess make-up included in Hicks-Ponder's fiscal 1966 conversion costs was equal to the difference between the actual make-up incurred in converting from civilian to government business and the lesser amount of make-up for retraining due to personnel turnover and production changes which Hicks-Ponder budgeted as a normal cost of doing business.

47. During the retraining period in fiscal 1966, Hicks-Ponder's production was less than budgeted by the company.

48. Notwithstanding reduced production, Hicks-Ponder was incurring certain fixed expenses that did not vary with production.

49. Hicks-Ponder reflected fixed expenses or overhead in its budget by allocating those expenses on a unit basis related to normal production expectations.

50. The company was unable to recover its overhead out of fiscal 1966 budget projections because production fell below expectations and the unrecovered or unabsorbed overhead became a 1966 conversion cost. Such conversion cost was also reflected in higher prices on the 1966 government orders.

51. From 1956 to 1964, the Del Rio factory had primarily been engaged in production of a felled seam denim boy's jean.

52. In 1964, production of the boys' jeans was transferred to a new factory and the Del Rio plant was converted to production of dress jeans.

53. The dress jean was virtually identical to the boys' jean in construction and involved a change in only one operation.

54. Conversion from production of boys' jeans to dress jeans did involve some fabric changes and one change of operation, but that conversion was minor when compared to the more numerous changes of operations required by conversion from production of dress jeans to army sateen fatigue trousers.

55. The sateen trousers were somewhat more complicated to manufacture than the dress jeans. Approximately 2.6 hours were required for production of a dozen sateen garments as compared to 2.0 hours per dozen of the dress jeans.

56. The Del Rio factory produced approximately 37.15 sateen trousers per operator per 8-hour day.

57. Conversion to production of poplin combat trousers at the Yuma plant involved major changes in operations whereas only minor changes, primarily with respect to cloth types, had been experienced at Yuma from the time the plant opened in 1961 until introduction of such poplin trousers.

58. The poplin combat trouser was a more complex item than the garments manufactured in plaintiff's normal production for the civilian market, since 57 different sewing operations and approximately 7.3 hours were required for the production of a dozen units as compared to 40 different sewing operations and 3.7 hours per dozen for the garments manufactured at Yuma before the poplin trousers.

59. The Yuma plant produced approximately 13.69 poplin trousers per operator per 8-hour day.

60. In addition to retraining operators to accommodate government production, Hicks-Ponder was required to purchase new machinery to be able to perform this work and to leave idle some equipment it had been using prior to undertaking government production. However, the new machinery was not limited in its use to government work but was also used in civilian work thereafter.

61. At the Yuma plant, approximately 40 percent of the existing equipment in the plant was not usable in government production and sat idle during the entire time Hicks-Ponder was manufacturing poplin combat trousers.

62. Because of the rearrangement of production lines, the purchase of new and different equipment and the retraining of operators in totally different sewing operations required by conversion to government production there was risk involved in Hicks-Ponder fulfilling its government contracts.

63. Prior to commencing government work, as well as during the period of government production, Hicks-Ponder was primarily engaged in the contract sales business.

64. In the contract sales business, Hicks-Ponder agreed with a customer to produce a predetermined number of garments at a specified price which the customer was obligated to purchase.

65. During its fiscal years 1966 through 1968, approximately 80 percent of Hicks-Ponder's total sales were of the contract variety with the bulk of such sales being made to Sears, J.C. Penney & Co. and Montgomery Ward. A percentage breakdown of its sales for 1964 through 1968 to major customers and commercial and government sales is as appears on Chart E following.

CHART E

	1964	*1965*	*1966*	*1967*	*1968*
Sears Roebuck	54%	55%	56%	52%	51%
J. C. Penney	10	10	9	15	14
Montgomery Ward	13	10	11	8	6
Subtotal for Major Customers	77	75	76	75	71
Government	—	—	3	9	2
Independent	23	25	21	16	27
Total	100%	100%	100%	100%	100%
Computed Sales to Major Customers (In Thousands)	$13,974	$15,235	$18,506	$19,438	$17,061

66. Hicks-Ponder's remaining sales (exclusive of those to DSA) were made to wholesalers and department stores for retail sale after the company had manufactured the garments for inventory in the hope of finding customers at the best price available.

67. When Hicks-Ponder was first required to take on government business, its existing contract operations were disrupted because the company then had no excess capacity.

68. At the Del Rio plant Hicks-Ponder was required to curtail jean production, and at Yuma the company was forced to discontinue its entire production of Sears' work pants and casual slacks.

69. Hicks-Ponder's government work terminated in January and February 1968. At or before that time it became apparent to company officials that the company would no longer be able to secure additional government work, either directly or by way of subcontract. Although it bid on a number of government solicitations, it found its bids were too high to secure the contracts.

70. Thereafter, Hicks-Ponder endeavored to regain its former position with its contract customers, but was unable to secure such contracts immediately. One reason was

because contracts for spring production were normally negotiated during the previous September, October and November. However, in addition it may have been due to an undetermined extent to a temporary decreased demand or excess capacity for products of the kind manufactured by plaintiff which existed at the time. This latter reason testified to by defendant's industry specialist is to some degree corroborated by the proxy statement incident to the merger of Blue Bell and Hicks-Ponder issued to stockholders on September 26, 1968, which reported—

> "During 1967 the apparel industry in general experienced depressed sales brought about by the pressure for reduced inventories at the wholesale and retail levels. This general condition contributed to Blue Bell's sales being below expectations, resulting in depressed profit margins, higher inventory financing requirements and higher selling and general and administrative expenses per dollar of sales volume. This general condition continued to affect Blue Bell's profits through the first quarter of its 1968 fiscal year. * * *"

71. Hicks-Ponder's government and nongovernment sales and gross profits for the years 1964–68 were as follows:

Hicks-Ponder Co.
Sales and Gross Profits 1964-68 (In Thousands)

	Sales			*Gross Profits*		
Year	*Reneg.*	*Other*	*Total*	*Reneg.*	*Other*	*Total*
1964		$18,148	$18,148		$2,712	$2,712
1965		20,314	20,314		2,607	2,607
1966	$ 715	23,635	24,350	$ 186	2,885	3,017
1967	2,310	23,607	25,917	804*	3,506*	4,310
1968	411	23,619	24,030	82	3,767	3,849

* See note to Chart F, *infra.*

72. Plaintiff's renegotiable and non-renegotiable receipts, income, costs and expenses for the 3 years 1966–68 were as shown on Chart F following.

73. The results of plaintiff's operations for the years 1962–68 are as shown in the figures on Chart B of this opinion.

74. A comparison of plaintiff's sales and profits for the same years including GFM in renegotiable sales is as shown on Chart G following.

75. When Hicks-Ponder discontinued government production in December of 1967 and January of 1968, the

CHART F

CHART F

Hicks-Ponder Co.

Income from Renegotiable and Non-Renegotiable Sales—Fiscal Years 1966-68 (In Thousands)

	Total Company			*Renegotiables*			*Other*		
	1966	*1967*	*1968*	*1966*	*1967*	*1968*	*1966*	*1967*	*1968*
Sales	$24,350	$25,880	$24,031	$715	$2,273	$411	$23,635	$23,607	$23,619
Material Savings Payments		37			37				
Total Receipts		25,917			2,310				
Materials	13,802	15,206	14,074	88	273	44	13,714	14,933	14,030
Direct Labor	4,088	4,977	5,194	284	765	118	3,804	4,211	5,076
Indirect Mfg. Expenses	3,018	3,410	3,518	211	502	91	2,807	2,908	3,427
Profit Sharing and Officers' Bonuses					(12)*			12*	
Net Change in Finished Stock Inventory	371	(1,986)	(2,604)	(53)	(23)	76	424	(1,964)	(2,680)
Total Cost of Goods Sold	21,279	21,607	20,182	529	1,506	329	20,749	20,101	19,853
Gross Profit	3,071	4,310	3,849	186	804*	82	2,886	3,506*	3,767
Selling and Shipping	803	897	1,129	33	61	12	771	836	1,117
Advertising	148	158	180	11	28	6	137	130	174
General & Administrative	773	757	886	57	136	32	716	622	854
Interest	254	201	283	19	23	9	235	179	274
Profit Sharing and Officers' Bonuses	241	322	289	14	64	5	227	258	284
Adjust Books to Tax Basis	(18)	(11)	(7)				(18)	(11)	(7)
Total Expenses	2,201	2,325	2,760	134	311	64	2,067	2,013	2,696
Net Profit for Reneg.	871	1,986	1,090	52	493	18	819	1,493	1,072
Other Income/Deductions	26	(26)	(61)				26	(26)	(61)
Net Income per Tax Return	$896	$1,960	$1,029	$ 52	$ 493	$ 18	$ 844	$1,467	$1,011

* In determining gross profits on renegotiable and other business for 1967, in the absence of better evidence, 50 percent of the $23,773 increase in renegotiable profits attributable to the reallocation of officers' bonuses and profit sharing expense is allocated to cost of goods sold and gross profits, and the remainder to expenses.

CHART G

Hicks-Ponder Co.
Comparisons of Sales and Profits for Years 1962-68
Including GFM in Renegotiable Sales (In Thousands)

Year	Net Sales	Cost of Goods Sold	Gross Profit	% Gross Profits to Sales	Net Profits	% Net Profits to Sales
1962	$14,583	$12,182	$2,402	16.47	$1,057	7.25
1963	16,349	14,026	2,323	14.21	781	4.78
1964	18,148	15,436	2,712	14.95	887	4.89
1965	20,314	17,283	3,031	14.92	665	3.27
Reneg. 1966	1,239	1,053	186	14.98	52	4.20
Other 1966	23,635	20,749	2,886	12.21	819	3.47
Reneg. 1967	4,057	3,253	804	19.82	493	12.14
Other 1967	23,607	20,101	3,506	14.85	1,493	6.32
Reneg. 1968	689	607	82	11.88	18	2.68
Other 1968	23,619	19,853	3,767	15.95	1,072	4.54

company incurred the expense of retraining the operators who had worked on govenment contracts to enable them to work on civilian production. Plaintiff claims that the cost of reconverting its Yuma, Arizona, plant to civilian production was $64,117, consisting of excess make-up in the sum of $29,144 and lost overhead absorption of $34,973, and that the cost of reconverting its Del Rio, Texas, plant to civilian production was $23,723, for a total cost of $87,840, all of which was incurred in fiscal 1968. Defendant's asserted comparable total cost is $16,697, of which 86 percent, or $14,359, should be allocated to 1967. For reasons discussed in the opinion it is found herein that the record does not support either total cost figure.

76. Plaintiff also claims that as a result of being unable to regain its civilian-contract position until after the end of fiscal 1968, plaintiff failed to absorb $128,719 in overhead expenses which it continued to incur and which would have been absorbed if production had continued at prior budgeted levels. For reasons likewise stated in the opinion no such finding is warranted by the record.

77. Plaintiff further claims a loss in 1968 profits of $94,000 as a direct consequence of the plaintiff having been engaged in government business from fiscal 1966 through

1968. However, for reasons discussed in the opinion the record also fails to support a finding to this effect.

78. In its civilian contract business, Hicks-Ponder incurred no expenses in locating or acquiring material which went into the finished garments because the purchaser of the finished garments originally located the material which it then sold to the company on the same terms as it had purchased the material.

79. Sears and Hicks-Ponder's other contract customers invoiced Hicks-Ponder for the material used in the garments at the time of shipment.

80. During its fiscal years 1966 through 1968, the standard payment terms for the material sold to Hicks-Ponder by its contract customers were net 70 days from date of shipment.

81. Shipment commenced when the material was picked up in Hicks-Ponder trucks at the mills.

82. The material arrived at Hicks-Ponder's plant within a week or less of the date of shipment.

83. Hicks-Ponder's sales to its civilian customers were made on a net 30 days from date of shipment basis.

84. Piece goods material used in Hicks-Ponder's civilian contract sales business during its fiscal years 1966–68 were on hand for approximately 90 to 120 days before being shipped to the contract customer as finished garments.

85. In its contract business, Hicks-Ponder ran no risk of being left with excess inventory of piece goods or finished garments because the company only purchased enough material necessary to fill an order for a predetermined number of garments which its customer was obligated to purchase.

86. Plaintiff was permitted to set up its own schedule for release and pickup of government furnished materials (GFM). GFM was picked up at the mills in Hicks-Ponder's own trucks and transported to the company at its own expense where it was inspected, shaded, marked, spread and cut just as was material for the civilian trade.

87. Although Hicks-Ponder was not required to pay for GFM, it could have obtained payment terms of net 70 days just as it did in its civilian trade since those were the standard mill terms at the time.

88. No discounts were allowed for payment in less than 70 days with respect to the poplins and sateens used in Hicks-Ponder's government business.

89. Omitted.

90. Initially GFM was on hand at Hicks-Ponder's plants for 3 to 4 weeks after it was picked up and before it was shipped out in the form of manufactured garments. The

time was reduced to 3 weeks after plaintiff was asked to accelerate production.

91. The turnover of GFM was more rapid than the turnover of civilian cloth, because DSA wanted immediate shipment of the garments as they came off the production line whereas Hicks-Ponder was able to some degree to produce garments for the full season in its civilian contract business as its own convenience dictated and hold them for shipment as the customer's sales warranted.

92. Garments sold to DSA were sold on 20-day payment terms.

93. During its fiscal year 1967, Hicks-Ponder maintained a profit-sharing plan for its employees. The company made annual contributions to the plan equal to "25% of its net income above 6% of the net worth of the company at the beginning of the taxable year; such contribution not to exceed 15% of the aggregate compensation of all participants."

94. Hicks-Ponder also had a bonus plan for certain key officers which entitled them to a fixed percentage of the company's profits. The percentage was set prior to the beginning of the year and payment was not discretionary.

95. For fiscal 1967, Hicks-Ponder incurred $322,320 of expense with respect to its profit-sharing and officer-bonus plans.

96. On its income tax return for fiscal 1967, as well as on its audited financial statement for that year, Hicks-Ponder deducted the $322,320 of profit-sharing and officer-bonus expenses and did not include this amount in cost of goods sold.

97. Hicks-Ponder's fiscal 1967 income tax return was audited by the Internal Revenue Service and the company's treatment of profit-sharing and officer-bonus expenses was not challenged.

98. For the 3 fiscal years, 1966, 1967 and 1968, Hicks-Ponder earned a total of $563,107 from renegotiable business.

99. In fiscal 1966, 1967 and 1968, Hicks-Ponder used a total of $2,548,253 of GFM in its renegotiable business.

100. For the 3 fiscal years, 1966, 1967 and 1968, Hicks-Ponder's total renegotiable sales excluding GFM were $3,436,114. Total renegotiable sales including GFM for the 1966 to 1968 period were $5,984,367.

101. For the 3 fiscal years 1966, 1967 and 1968, Hicks-Ponder's total renegotiable profits were 16.39 percent of renegotiable sales excluding GFM while they were 9.41 percent of renegotiable sales including GFM.

102. For the 5 fiscal years 1961 through 1965, Hicks-Ponder's average annual rate of profit return on sales was 5.67 percent.

103. Hicks-Ponder's rate of profits to sales for the fiscal years 1963 through 1966 were affected by rapid growth which involved heavy expansion expenses. The company increased employment by 55 percent during that period and greatly expanded its plant capacity.

104. During its fiscal year 1967, the rate of Hicks-Ponder's non-renegotiable profits as a percent of sales was greater than in the 4 preceding fiscal years because among other reasons the company experienced no expansion of capacity and because of the installation of formal budgeting procedures which allowed the company to ascertain more accurately all of the costs which had to be properly reflected in its prices.

105. Plaintiff's return of operating profit ($1,124,615) on beginning capital (defined as total assets, or stockholders' equity plus debt) for its fiscal year 1962 ($4,065,464) was 28 percent. Its return on stockholders' equity alone ($2,541,285) was 44 percent for 1962.

106. Defendant's FBI-accountant witness used various alternative methods for allocating capital and equity between renegotiable and non-renegotiable business for 1967. The first method was to compare cost of goods sold for renegotiable business with total cost of goods sold, including GFM in both. This produced a 14 percent allocation to renegotiable business. An alternative comparison without GFM came out to a 7 percent allocation of capital for renegotiable business. The second method was to compare renegotiable direct labor with total labor. This showed a 15 percent allocation for capital used in renegotiable business. The third method compared direct labor for the 3 years 1966–68 for renegotiable business with total direct labor for the same years, resulting in an 8 percent allocation. The fourth method derived its allocation from the proportion which 1967 renegotiable sales bore to total sales, both without GFM. From this there was derived a 9 percent allocation. The fifth method compared renegotiable sales for the 3 years with total sales for the 3 years, producing a 5 percent allocation of capital used for renegotiable business. The sixth method compared specific assets used in production for renegotiable business with total assets. From this the witness derived a 9 percent allocation. Although the witness preferred method three, which produces an 8 percent allocation of capital used in renegotiable business to total capital, he concluded that an average of the various methods should be used. This resulted in an allocation of 10 percent of capital and equity

to renegotiable business and 90 percent to non-renegotiable business for the fiscal year 1967.

107. Plaintiff proposed no particular figure for allocation of capital and equity to renegotiable business and to non-renegotiable business.

108. As of the beginning of plaintiff's fiscal year 1967 plaintiff's stockholder equity was $5,017,164 and total capital employed in the business (total assets, or stockholder equity plus debt) was $10,407,322, including therein $2,839,995 in current liabilities.

[Findings 109–112 deleted; duplicated in opinion.]

113. Four other manufacturers of trousers with average 1967 renegotiable sales of $2,100,000 and which were cleared without action by the Renegotiation Board had an average of 10.03 percent profits to renegotiable sales (without GFM) for 1967.[1]

114. During 1967 a number of manufacturers of combat and sateen trousers made renegotiable profits that were deemed excessive by the Renegotiation Board. The following chart shows the name of the company, the sales before and after renegotiation excluding GFM, the profits before and after renegotiation, and the percent of profits to sales.

	Before Renegotiation (In Thousands)			*After Renegotiation*		
Company	*Sales*	*Profits*	*%*	*Refund*	*Sales*	*Profit*	*%*
J. M. Wood	$4,271	$ 715	16.7	$ 225	$4,066	$490	12.1
Staham	1,705	260	15.2	50	1,655	210	12.7
Glenn Berry	5,013	937	18.7	250	4,763	687	14.4
Guy James	3,650	1,112	30.5	725	2,925	387	13.2
Winfield	7,157	2,696	37.7	2,100	5,057	596	11.8
Plaintiff	2,310	521	22.6	275	2,035	246	12.1
MLW Corp.	1,399	215	15.4	75	1,324	140	10.6
Average	3,644	922	22.4	529	3,118	394	12.4

115. On January 27, 1966, plaintiff received a valid order for sateen trousers under contract No. DSA 100–2162 at a net price of $2.76 per pair (less GFM of $1.33). On the same day, Mann Mfg., Inc. received a rated order at $2.54 a pair. Oxford Mfg. Co. received a rated order at $2.41 per pair. Clefton Mfg. Co. received a rated order for $2.71 per pair. However, Dickson Jenkins Mfg. Co. also received a rated order for sateen trousers on January 27, 1966, and the price was $3.10 per pair. Within 30 days prior to the date selected by defendant and 30 days after that date, rated

[1] The four contractors and their percentages were: Lankford and Sons, 8.0%; Tennessee Overall Co., Inc., 12.0%; Hubbard Pants, 6.4%; and Lerner Slone Clothing Corp., 13.7%.

orders for sateen trousers were issued to many contractors at prices higher than $2.76 per pair; *e.g.*, $2.83 net to Choctaw Mfg. Co., $3.08 net to J.M. Wood, $3.03 to Glenn Berry, $2.90 net to Progressive Coat & Apron, $3.27 to Smith Bros., $3.32 net to San Benito, $3.35 to Steiner Lobman Dry Goods, $2.95 to Oshkosh B'Gosh, $2.77 net to New Hebron and Williamson Dickie and $2.99 net to Progressive Coat & Apron.

116. On May 18, 1966, defendant awarded through negotiation eight contracts for sateen trousers, including one to plaintiff at a net price of $2.76 a pair (less GFM). Except for the award to Mann Mfg. and plaintiff, all contracts were FOB destination.

117. On May 16, 1966, plaintiff and three other companies were awarded contracts for combat trousers. Plaintiff's contract was FOB origin, while two others were FOB destination. Plaintiff's cut, make and trim price was $4.75 per pair. The others were respectively $4.80, $4.38 and an average of $4.04.

118. Plaintiff was the unsuccessful bidder on a number of government contracts for which bids were advertised in 1967.

119. The last prime contract received by plaintiff for sateen trousers was DSA 100–4275 awarded May 18, 1966, at a total net price of $2.76 a pair (including the value of GFM), which contract was negotiated.

120. The cotton sateen contracts on which plaintiff was the unsuccessful bidder were awarded to other bidders at prices ranging from $2.22 to $2.49 a pair (including GFM). On one bid opening in January 1967 plaintiff's bid ranged from $2.64 to $2.80 for different quantities. Plaintiff's prices on other solicitations also remained higher although its exact bids are not in the record.

121. The quality of trousers produced by Hicks-Ponder was good and rejections were extremely minute.

122. Hicks-Ponder's delivery record was excellent with all deliveries being made on schedule.

123. Hicks-Ponder was economical in the use of materials, facilities and manpower and made very effective use of its facilities.

124. The Government rated Hicks-Ponder's performance "Excellent" and issued a "Quality Award" to the company.

125. Prices charged to the Government by Hicks-Ponder were in line with those paid by the Army for the manufacture of the type of trousers involved.

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CONCLUSION OF LAW

Upon the foregoing findings of fact and for the reasons set forth in the opinion, pursuant to Rule 148, the court concludes and determines as a matter of law that plaintiff as successor in interest to the Hicks-Ponder Company realized excessive profits of $150,000 for its fiscal year ended October 31, 1967, from contracts and subcontracts subject to renegotiation under the Renegotiation Act of 1951, as amended. The case is remanded to the trial judge for further proceedings in the event the parties are unable to agree as to the appropriate allowance for state and federal income taxes and interest on the net amount to be repaid to the Government by plaintiff.

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553 F.2d 672

HECTOR CRUZ-CASADO v. THE UNITED STATES

[No. 214–75. Decided April 20, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Military pay; invalid discharge; measure of recovery; reinstatement.—Plaintiff, a former major in the Regular Army of the United States, on October 23, 1973, was removed from his post with an honorable discharge but with a prohibition against his future reenlistment. Although plaintiff was technically charged by the removal selection board with personal misconduct and conduct unbecoming an officer, the gravamen of the Government's complaint was his alleged homosexual advances towards two enlisted men. Plaintiff contends his removal was contrary to Army regulations, and seeks back pay and reinstatement. It is *held* that defendant violated procedures set down in paras. 5–8, 5–9a, and 5–15 of AR 635–100 requiring defendant to secure a psychiatric opinion on plaintiff's alleged homosexuality prior to discharge. Plaintiff is entitled to recover back pay and allowances as provided by law, less appropriate offsets, to be determined in further proceedings under Rule 131(c). Pursuant to 86 Stat. 652, 28 U.S.C. § 1491 (Supp. III, 1973), it is ordered that the Secretary of the Army reinstate plaintiff and that his records be corrected to remove all adverse references pertaining to the 1972–73 proceedings and discharge.

Opinion of the Court

Plaintiff's motion for summary judgment is granted and defendant's cross-motion is denied.

Military pay; regulation of Executive Department; necessity for compliance with.

[1] An agency must follow its own regulations, and a discharge brought about in violation of those regulations is invalid and cannot stand. Violation of a single regulation is sufficient to void a separation action, so long as it is substantial and prejudicial. Where defendant failed to secure a psychiatric opinion on plaintiff's alleged homosexuality prior to its judgment to terminate his service, this constituted violation of procedures set down in Army Regulation 635–100, paras. 5–8 and 5–9a, as well as para. 5–15, the fact that plaintiff was charged with personal misconduct and conduct unbecoming an officer rather than with homosexual acts or tendencies being immaterial since the gravamen of the complaint was his supposed homosexual conduct. The alleged misconduct and conduct unbecoming charges are subsumed in the alleged homosexual conduct.

Armed Services ⚖11

Military pay; correction of military records; discharge, wrongful or invalid; recovery, measure of.

[2] Where the court determines that plaintiff's discharge was invalid and cannot stand, plaintiff must be presumed to have continued in the service during the intervening years, must be paid accordingly, and again must be placed on the active duty list.

Armed Services ⚖11, 13.1(15)

Alan Dranitzke, attorney of record, for plaintiff.

John W. Showalter, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Senior Judge*, NICHOLS and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

This military pay case is before the court on plaintiff's motion and defendant's cross-motion for summary judgment. The material facts are not in dispute. On October 23, 1973, plaintiff was removed from his post as a major[1] in the Regular Army of the United States, with an honorable discharge but with a prohibition against his future reenlistment, pursuant to the recommendation of a board of inquiry as modified and affirmed by a board of review

[1] This was his temporary grade. His permanent rank at the time was that of captain.

and ultimately by the Secretary of the Army. By suit filed June 24, 1975, plaintiff contests this removal as contrary to Army regulations and therefore invalid, entitling him in this action to back pay and reinstatement. For reasons stated below, we agree with plaintiff and award him the relief requested.

Plaintiff's discharge came about in the following fashion. After service as an Army officer for 12 years, during which time he rose from second lieutenant to major, plaintiff was charged by a removal selection board in November 1972 with acts of personal misconduct and conduct unbecoming an officer in that he made homosexual advances to two enlisted men, one to PV2 Edwin Eugene Hagan at Fort Leonard Wood (Missouri) on April 16, 1972, and the other to SP5 James Lee Felty in Vietnam on May 9, 1967. The effect of these charges was to bring plaintiff before a board of inquiry (hereinafter the board) on February 27, 1973, to show cause why he should be retained as an Army officer. The proceedings before the board were not criminal in nature, but rather amounted to an administrative "elimination" action under 10 U.S.C. § 3791 (1970) and Army regulation (AR) 635–100 (1970), in which the Government, pursuant to paragraph 5–32 of the regulation, bore the burden of proving plaintiff unfit for retention by a preponderance of the evidence.

At the hearing before the board, the Government introduced affidavits relating to both the Felty and Hagan incidents, though live testimony was presented only on the latter. The Government's affidavits and testimony on the Hagan incident were to the effect that plaintiff approached Hagan outside an eating club at Fort Leonard Wood and made a homosexual proposal to him. Hagan supposedly started to leave the base with plaintiff in the latter's car, described by Hagan as a white Volvo, but when plaintiff became lost trying to find the exit from the base, Hagan directed him toward the base movie theater. Hagan then fled from the car, notified the military police of the alleged solicitation, and in addition related the incident to two companions of his, Private James Doenhoefer and Private Robert McKitrick. The affidavits and testimony of Hagan, Doenhoefer, and McKitrick did not agree on whether

Hagan told his companions that the party who solicited him was carrying a gun, or only that Hagan thought he might have had a gun. Hagan's affidavit stated, in response to questions, that Hagan did not know why he stepped into the soliciting party's car, or why he told others about the gun. Doenhoefer's affidavit related that the license number of the car plaintiff allegedly drove was G5Y 663, which he recorded when he and his companions, and supposedly plaintiff, saw the car, shortly after the solicitation and just before the car left the base. Hagan alone identified plaintiff as the one who made the solicitation.

Plaintiff's case consisted of his testimony denying the Hagan charge, affidavits and testimony attesting to plaintiff's good character and efficiency as an officer, his record of decorations, a number of highly complimentary officer effectiveness reports, and a stipulation of expected testimony from the manager of a local car rental agency stating that on the date of the Hagan incident plaintiff had rented from his agency a white Subaru[2] bearing Missouri license number GX 6035. The board took this evidence under advisement, and made its determinations. Like a board of inquiry which convened in 1970 to pass on the Felty incident, the board in 1973 found that the 1967 charge was "unsubstantiated." However, it found that plaintiff had made a homosexual solicitation to Hagan, and on this basis ordered plaintiff removed from the Army with a less than honorable discharge. A board of review approved the board's action on May 16, 1973, with the modifications that plaintiff's discharge be honorable but that he not be permitted to reenlist. The Secretary of the Army affirmed this recommendation on September 26, 1973, and plaintiff was discharged in the following month.

About one week before his discharge became effective, plaintiff applied to the Army Board for the Correction of Military Records (ABCMR) to have the impending separation voided, citing plaintiff's record of decorations and several commendatory effectiveness reports either unavailable during, or issued subsequent to, the hearing before the board. In January and February of 1974, plaintiff un-

[2] The agency did not rent Volvos, according to the stipulation.

derwent psychiatric and psychological examination at a Veterans Administration clinic in San Antonio, Texas, resulting in statements from one psychiatrist and two psychologists that plaintiff showed no signs of a "sexual pathology," that he possessed "a healthy identification with the male role," and that his disavowal of homosexual acts and tendencies was supported by the tests. In late February the ABCMR denied plaintiff's request for a hearing and refused to alter his records. Thereafter, in March, plaintiff took a polygraph examination, the results of which concurred with his denial that he was a homosexual or committed homosexual acts. A supplemental application filed with the ABCMR the next month recited the polygraph results, appended statements by a number of officers attesting to plaintiff's good character and exemplary service as an officer, and called attention to the then newly discovered fact that Hagan had a record as a juvenile delinquent, having been charged in 1971 with grand larceny and breaking and entering.[3] The supplement did not mention the psychiatric and psychological testing. In June, the ABCMR again denied plaintiff's requested hearing and relief. This suit followed.

Plaintiff contends that a variety of defects in the board proceeding, and the arbitrariness and capriciousness of the ABCMR's refusal to grant plaintiff a hearing and correct his records, require the invalidation of his discharge and his reinstatement in the Army, with appropriate back pay and correction of records. As defects he cites a failure to specify in the board's convening orders the incidents to be investigated, consideration of the Felty incident as improperly placing him twice in jeopardy, failure to conduct a psychiatric examination regarding his alleged homosexuality, overreaching by the board's legal adviser, denial of plaintiff's right to confront and cross-examine his accuser, application of the wrong standard of burden of proof, and various other errors, all in violation of Army regulations and due process. It is elementary that an agency must follow its own regulations, and that a discharge brought

[3] An Army report dated April 1972 recorded these charges. There is no indication that anyone involved in the board proceeding on the Government's behalf knew of these charges.

about in violation of those regulations is invalid and cannot stand. *Service* v. *Dulles*, 354 U.S. 363 (1957); *Bray* v. *United States*, 207 Ct. Cl. 60, 515 F. 2d 1383 (1975). Further, the violation of a single regulation is sufficient to void the separation action, so long as it is substantial and prejudicial. *Pascal* v. *United States*, 211 Ct. Cl. 183, 543 F. 2d 1284 (1976); *Rasmussen* v. *United States*, 211 Ct. Cl. 260, 543 F. 2d 134 (1976); *Henderson* v. *United States*, 175 Ct. Cl. 690 (1966), *cert. denied*, 386 U.S. 1016 (1967).

AR 635–100, paragraph 5–8, prescribes that, in the case of an officer being considered for administrative separation, "[w]hen it is considered that the officer's mental condition has contributed to his military inefficiency or unsuitability as specified," he will be medically examined, such evaluation to "include a psychiatric study of the individual, when appropriate." Paragraph 5–9*a* specifies that for officers being considered for separation under paragraph 5–12*a*(7) with "[c]ommission or attempted commission of a homosexual act," or under paragraph 5–12*a*(8) with "[e]xistence of homosexual tendencies," the medical evaluation "including the psychiatric study of the individual will include the following: * * * (2) Opinion regarding the existence of homosexuality." Paragraph 1–3*x* defines a homosexual act to cover "any proposal, solicitation, or attempt to perform such an act." Though plaintiff was examined by a psychiatrist to ascertain his capacity to comprehend and participate in the proceedings against him, and his ability to distinguish right from wrong and adhere to the right, no opinion was given by the examiner regarding plaintiff's alleged homosexuality. It is true that plaintiff was technically charged by the removal selection board with personal misconduct and conduct unbecoming an officer, under paragraph 5–12*a*(6) and (10), respectively, rather than with homosexual acts or tendencies under paragraph 5–12*a*(7) and (8). However, it is abundantly clear from the specifications and the record before the board that the gravamen of the Government's complaint against him was his supposed homosexual conduct and nothing else. It would elevate form over substance to follow the reasoning urged by the Government, that the necessity for the psychiatric opinion on homosexuality never comes into

play unless the charges against an officer specifically single out paragraph 5–12*a*(7) and (8) as their basis. We decline to endorse such a theory, but rather hold that defendant violated the explicit procedures set down in paragraphs 5–8 and 5–9*a* when it failed to secure a psychiatric opinion on plaintiff's alleged homosexuality prior to its judgment to terminate his service. The alleged "misconduct" and "conduct unbecoming" charges are subsumed in the alleged homosexual conduct.

Paragraph 5–15*a* of AR 635–100 instructs that a commanding officer hearing of allegations that one of his subordinates has engaged in homosexual conduct "will inquire thoroughly and comprehensively into the matter * * *, bearing in mind the peculiar susceptibility of such cases to possible malicious charges." Paragraph 5–15*b* goes on to provide that among the facts collected concerning the charges will be "(3) [m]edical evaluation reports as specified in paragraph 5–9." If there could be any doubt regarding the regulation's requirement that the professional opinion be obtained, this provision should put the matter to rest. That the language of paragraph 5–15 mandates the opinion in a case like plaintiff's, where charges have not been placed under paragraph 5–12*a*(7) and (8), is evident from the fact that it speaks to a situation where only allegations of homosexuality are involved, quite apart and prior in time from the bringing of formal charges. Defendant's omission in not securing the psychiatric opinion is equally a violation of paragraph 5–15.

It is obvious that defendant's failure substantially and prejudicially abridged plaintiff's procedural rights. Subsequent psychiatric and psychological testing resulted in firm denials by three professionals employed by the Veterans Administration that plaintiff possessed any homosexual traits or identification. To the contrary, their examinations of plaintiff revealed that he adhered unwaveringly to socially accepted sexual norms. An opinion to this effect, placed before the board before plaintiff's discharge, no doubt would have given the board pause. This much the Government owed plaintiff, under its own regulations. We think that the board, acting in good faith, was apparently and justifiably concerned with the exist-

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ence of multiple charges of homosexuality against plaintiff. In such circumstances, the professional opinion required by the regulations was all the more needed to prevent improper disposition of the case.

In view of the Government's failure to follow its own published regulations, in a manner that substantially and adversely affected plaintiff's rights, the discharge cannot stand. Since the Correction Board improperly failed to correct the error we will do so. Plaintiff must be presumed to have continued in the Army during the intervening years, must be paid accordingly, *Bray* v. *United States, supra,* and again must be placed on the active duty list. In view of the holding we have made based on a single but substantial and prejudicial legal error, we find it unnecessary to address plaintiff's other contentions. It is, therefore, concluded that plaintiff is entitled to recover back pay and allowances as provided by law, less appropriate offsets, to be determined in a further proceeding pursuant to Rule 131(c). It is ordered pursuant to 86 Stat. 652, 28 U.S.C. § 1491 (Supp. III, 1973), that the Secretary of the Army reinstate plaintiff and that his records be corrected to remove all adverse references pertaining to the 1972–73 proceedings and discharge. Plaintiff's motion for summary judgment is granted. Defendant's cross-motion for summary judgment is denied.

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555 F.2d 290

MISSOURI BAPTIST HOSPITAL v. THE UNITED STATES

[No. 801–71. Decided April 20, 1977. Plaintiff's motion for rehearing denied May 27, 1977]

ON THE PROOFS

Contracts; lease; failure to make repairs; measure of damages.— Plaintiff seeks to recover damages arising from defendant's failure to return the leased old hospital building to the lessor in good condition, ordinary wear and tear excepted, at lease termination. Plaintiff urges that cost of restoration is not the same as cost of repair and that in measuring damages a different standard should apply. It is *held* (1) that

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repair costs respecting the leased premises are subject to a ceiling, and that ceiling is the diminution in fair market value attributable to the breach; (2) that plaintiff's reliance on a possible distinction between cost of repairs and cost of restoration is unfounded in view of the similarity in treatment of the two methods in the case law, and because the rationale of the rule as applied to cost of restoration cases (i.e. avoidance of windfall recovery) is equally applicable to cost of repair cases; (3) that plaintiff has failed to meet and carry its burden of proof that it was damaged—while it carried its burden regarding cost of repairs, it failed to meet and carry its burden that diminution in market value attributable to the breach exceeded the cost of repairs; (4) that there is no adequate and conclusive evidence indicative of fair market value on "day in" and that the fair market value on "day out" was zero; (5) that defendant is not entitled to recover on its counterclaims; and (6) that plaintiff is not entitled to recover on its belated claim premised on Art. XXIII of the lease. Plaintiff is not entitled to recover and the petition and counterclaims are dismissed.

Contracts; lease; covenant to repair leased premises; damages, measure of for breach.

[1] Where the cost of repair of leased premises exceeds the diminution of the leasehold's fair market value, in measuring damages for breach of a covenant to return the leased premises in good condition, ordinary wear and tear excepted, the applicable standard is not the cost of repair but the diminution in fair market value caused by acts of the lessor. The overall purpose of this measure of damages rule is to avoid windfall recoveries, such purpose being no less well served in a cost of restoration situation than in a cost of repair situation.

Landlord and Tenant ⚖160(4)

Contracts; lease; breach of covenant to repair; burden of proof.

[2] In an action for breach of covenant to repair leased premises, the lessor must first show what the cost of repair is and, in order to benefit by the full measure of cost of repair, he must show that the diminution in fair market value attributable to the breach exceeds the cost of repair. Thus, lessor must show that he was damaged; to require the lessee to expend great sums of money to repair the premises, if the damage to the value thereof was *de minimis*, is to work an injustice.

Landlord and Tenant ⚖160(4)

Contracts; lease; covenant to repair leased premises; damages, measure of for breach.

[3] If the diminution in fair market value attributable to a breach of covenant to repair leased premises exceeds the cost of repair damages, the entire cost of repair may be awarded. In any event, cost of repair damages are the maximum recovery one can receive, regardless of the diminution in value.

Landlord and Tenant ⚖160(4)

Evidence; weight and sufficiency of evidence.

[4] A letter ostensibly showing a possible offer of a stated sum of money for the subject property submitted in evidence to dispute testimony

concerning value of the property, is inadmissible as an offer establishing fair market value.

Evidence ⚖113(16)

Pleading and practice; trial judge's report; exceptions to findings. [5] Where the trial judge found no conclusive evidence of fair market value of the subject premises on "day in" and "day out," and plaintiff failed to except to the findings either before the trial judge or at oral argument, to press for remand, or to offer to file supplemental briefs or affidavits, it is now too late for remand relief and inconsistent with Rule 143(d).

Landlord and Tenant ⚖160(4)

Contracts; interpretation; contemporaneous construction of parties. [6] The court is justified, when interpreting disputed terms of a contract, in relying on the contemporaneous construction of the parties before the matter was subjected to litigation.

Contracts ⚖170(1)

Jack Rephan, attorney of record, for plaintiff. *Danzansky, Dickey, Tydings, Quint & Gordon*, and *Robert W. Copeland*, of counsel.

John E. Lindskold, with whom was *Assistant Attorney General Peter R. Taft*, for defendant.

Before NICHOLS, KUNZIG, and BENNETT, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

This suit seeks to recover damages emanating from a lease by plaintiff, Missouri Baptist Hospital (Missouri Baptist) to defendant, of certain real property located in the City of St. Louis, Missouri. This case was heard before Trial Judge Thomas J. Lydon, who has submitted a recommended decision and conclusion of law, proposing a recovery for Missouri Baptist of $120,292, based on the Government's failure to make repairs to the building at the termination of the lease. Recovery was denied to the Government for its two asserted counterclaims. A belated claim by the plaintiff was also denied. Both parties excepted to the trial judge's opinion.

After briefing and oral argument, it is determined that we cannot adopt the full decision recommended by the trial judge, as we find the damages to have been reached under an erroneous legal standard. We hold that where the cost

of repair of leased premises exceeds the diminution of the leasehold's fair market value, it is error to apply as the measure of damages owed the lessor, the "cost of repair" standard rather than the diminution in value standard. We further hold that plaintiff had the burden of proof in this case to show not only the cost of repairs, but also the diminution in fair market value, so as adequately to prove his true damages. Plaintiff failed in this regard, and cannot recover.

That portion of the trial judge's decision denying defendant's counterclaims and denying plaintiff's belated claim is adopted by the court and included with this opinion, *infra.*[1]

In 1958, prior to the execution of the lease in question, plaintiff operated a hospital in the downtown area of the City of St. Louis. Because of the declining condition of the neighborhood, the age of the building, and the expense of renovation, plaintiff built a new hospital in the suburbs. In early 1965, plaintiff began to phase out the old hospital. By December 31, 1965, the old hospital was vacated and remained vacant until July 1, 1966. Plaintiff was unsuccessful in attempting to sell the property.

In October 1965, the Job Corps, Office of Economic Opportunity (OEO) began studies to determine the suitability of the old hospital as a site for a Job Corps Center for Women. Although the building had its shortcomings, in June 1966, OEO finally decided to utilize the old hospital. OEO entered into a cost-plus type of contract with Delta Corporation (Delta) to operate a Women's Job Corps Center. In June 1966, Delta leased the old hospital from plaintiff at an annual rental of $125,000 for a term of 38 months, ending August 31, 1969. Delta spent over $600,000 in repairing and rehabilitating the building. During the period the Center was operating, the maintenance and repair costs were extremely high—between $75,000 and $80,000 per year because of the age of the building.

The Job Corps Center for Women was closed in June 1969. Delta assigned the lease to the Department of Labor

[1] The court adopts the trial judge's findings of fact, as modified, which are necessary for our determination. They are set forth in his report filed March 8, 1976, and are not printed herein since all necessary facts are contained in this opinion.

(Labor) which had absorbed this portion of OEO. Plaintiff and Labor amended the lease to provide for a month-to-month tenancy, commencing September 1, 1969, at a reduced rental. The building was used for temporary storage of Job Corps personal property.

In early January 1970, Labor decided to terminate the lease and vacate the building by January 31, 1970. Some areas of the building were not adequately maintained and repaired and, therefore, at the termination of the lease, *the building was not delivered to plaintiff in good condition, ordinary wear and tear excepted, as required by the lease provisions.*

Plaintiff brought this action to recover damages arising from defendant's failure to deliver the premises in good condition, ordinary wear and tear excepted, at the termination of the lease. Plaintiff alleged in the petition that defendant's breach of the lease damaged plaintiff's property "as a result of which the *value* of such property *was diminished* by the sum of One Million Dollars * * *" (Petitition, p. 9)(emphasis added).

The trial judge, applying the *cost of repair as the measure* of damages, held that plaintiff was entitled to recover $120,292.[2]

In reaching this award, the trial judge stated that plaintiff's witness did not take into consideration in his repair cost estimate any allowance for reasonable wear and tear arising from the use of the building as contemplated by the lease. Consequently, the repair estimate figure was reduced by fifty percent (50%) as an allowance for reasonable wear and tear. Plaintiff contends that the

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[2] At this point, the components of the trial judge's recommended award should be clarified since the briefs and argument evidenced some confusion as to the actual figures. Part of the hospital was known as Wing A. As to Wing A, the trial judge found that there were no reliable damage estimates submitted by the parties. The plaintiff had sought to recover the fair market value of Wing A as damages. The trial judge determined that $17,868 was the proper measure of damages as attributed to Wing A, a figure falling far short of plaintiff's requested relief.

The $17,868 figure, combined with $102,424 (50% of the finding of $204,848 cost of repair figure for the rest of the hospital) totals $120,292, which is the amount of the recommended recovery.

Since we hold that in this case the entire award, if any, should be determined by a diminution in fair market value measurement, the detailed particulars of the trial judge's recommended award need not be further considered.

finding that plaintiff's witness failed to take wear and tear into consideration was contrary to the evidence in the record. Alternatively, plaintiff urges that even if the witness did *not* take wear and tear into consideration, the use of a 50% reduction factor was improper.

From our analysis of the record, it is conceivable that plaintiff's exceptions contain certain merit. However, since we hold for the Government on the issue of burden of proof, and that in this case, diminution of value is the proper measure of damages, we need not reach plaintiff's exceptions.

This brings us to defendant's exceptions. The Government maintains that the proper measure of damages in this case is not the "cost of repair," but diminution in the fair market value caused by the acts of the defendant.

The Government further argues that plaintiff has failed to establish by a preponderance of the evidence that the fair market value of the leasehold property was diminished by the Government's failure to abide by the terms of the lease. The Government introduced expert testimony that the property had no value on January 31, 1970.[3] Since the defendant also argues a total failure of proof by the plaintiff of value of the property on June 24, 1966, defendant alleges that plaintiff cannot show it actually suffered damage by virtue of defendant's breach of the lease.[4]

The nature of the Government's two counterclaims and the plaintiff's belated additional claim are adequately explained and dealt with by the trial judge, and that portion of his opinion dealing with these issues is printed after the Government's principle exceptions are reviewed in full.

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[3] For the purposes of clarity, we shall henceforth call January 31, 1970 (the day the lease was terminated) "day out." June 24, 1966 (the day the parties entered into the lease agreement) will be termed "day in."

[4] As we agree with these exceptions, we need not explore the Government's alternative argument pressed at oral argument, that the plaintiff's award be cut by $37,500. The trial judge found that the poor condition of the building was due in part to vandalism and causes other than defendant's actions. This finding was not excepted to by the plaintiff. The Government urges that before the total award of $204,848 was reduced by 50% to reflect normal wear and tear, the trial judge should have reduced the figure by $75,000 to reflect such outside causes. Were this to be done, plaintiff's "cost of repair" recovery would be cut by $37,500.

Preliminarily, the Government has conceded that it breached, in part, various provisions of the lease.[5] We need not spell out in detail each of these infractions—suffice it to say that the Government failed to return the property to the lessor in the manner and condition prescribed by the lease.

The Government relies on cases such as *Bowes* v. *Saks & Co.*, 397 F.2d 113 (7th Cir. 1968); *Dodge Street Building Corp.* v. *United States*, 169 Ct.Cl. 496, 341 F.2d 641 (1965); *Spitzel* v. *United States*, 146 Ct.Cl. 399 (1959); *Realty Associates, Inc.* v. *United States*, 134 Ct.Cl. 167, 138 F.Supp. 875 (1956); and *Eaddy* v. *United States*, 134 Ct.Cl. 338 (1956) to support its contention that the measure of damages for breach of a covenant to return the leased premises to the lessor in its original condition, is not the cost of repair *where such cost exceeds the diminution in fair market value of the premises.*

Plaintiff strenuously urges that these cases concern cost of restoration clauses and not cost of repair clauses; that costs to restore are not the same as costs to repair premises; and that a contrary rule should apply in repair cases. We disagree, and hold for defendant except with regard to its two counterclaims, which we deny pursuant to the trial judge's opinion, *infra.*

I.

The overall purpose of the aforementioned measure of damages rule, as we see it, is to avoid windfall recoveries. This was well stated in *Associated Stations, Inc.* v. *Cedars Realty & Development Corp.*, 454 F.2d 184,188 (4th Cir. 1972).

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[5] Specifically, the following paragraphs of the lease agreement were relied on by Missouri Baptist.

XI.
FURNISHINGS

* * * Lessee agrees to return all light fixtures, permanent installations of the building, or any fixtures or equipment permanently attached to the building and constituting a part of the realty thereof, or any air conditioning equipment, or air conditioners, at the termination of this lease, subject to wear and tear caused by normal usage of such furnishings and fixtures with no obligation to restore any furnishings or fixtures to their condition at the inception of this lease, except for such items as may have been damaged or broken.

The object of damages in a contract case is to restore the plaintiff to the position he would have been in had the contract not been breached. (Footnote omitted.) The "cost of restoration" method is one convenient way of determining the amount of damages to be awarded the plaintiff where a breach has occurred. There are, however, certain situations where this method of computing damages does not restore the plaintiff to the position he would have been in had the contract not been breached, but rather places him in a better position, thus providing him with a windfall. In those cases, courts have resorted to alternative methods of computing damages in order to insure that, as far as possible, the plaintiff neither loses nor benefits from the breach. * * *

The purpose of avoiding windfall recoveries is no less well served in a *cost of restoration* situation than in a *cost of repair* situation. A familiar example will illustrate. A broken $10 watch might take $30 worth of repair work to fix, whereas its diminution in value could at most be $10. A $30 recovery from an imaginary watch-lessee who caused the watch to break could inspire the plaintiff to discard the broken watch, purchase a new one for $10, and realize a windfall of $20.

We note that the authorities have in the past used *repair* and *restoration* interchangeably. In *Associated Stations, Inc.* v. *Cedars Realty & Development Corp., supra* at 186, n.3, for example, the terms of the lease clearly provide that

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XII.

ALTERATIONS, IMPROVEMENTS AND FIXTURES

* * * * *

Lessee may attach any fixtures or equipment to the leased premises which it deems necessary or desirable, at Lessee's own expense. At the termination of the lease, Lessee may remove any such fixtures, * * * or equipment if the removal of same does not deface, or damage the leased premises.

* * * * *

XIII.

REPAIR AND MAINTENANCE

Lessee hereby accepts the premises in the condition they are in at the beginning of this lease and agrees to maintain both the exterior and interior of said premises in good, clean and sanitary condition and in good order and repair and at the termination of this lease, will deliver the leased premises to the Lessor in good condition, * * *, excepting only reasonable wear and tear arising from the use thereof under this agreement. * * *

XIV.

WASTE

Lessee agrees that it will not permit or suffer any waste to the premises; * * *.

the lessee would be responsible for the costs of repair. Yet in his opinion, Judge Winter speaks of "cost of restoration" as being subject to a ceiling set by "diminution in market value."

In *Bowes* v. *Saks & Company*, 397 F.2d 113,116–17 (7th Cir. 1968), a restoration case, the court held that "cost of repairs" is a convenient way to quantify "costs of restoration" within the facts of that case. As such, it held the cost of repairs subject to diminution in market value. We quote at length from that opinion:

> In the ordinary lessor's suit for breach of a covenant to restore, the lessor is entitled to damages he actually suffers. Two rules are commonly applied to measure these damages:
>
> 'A lessee who breaches a provision of the lease requiring him to make certain repairs or to deliver up the premises at the termination of the lease in a certain condition is liable in damages for the reasonable cost of making such repairs or of putting the premises in the condition prescribed by the lease.' *Crystal Concrete Corp.* v. *Town of Braintree*, 309 Mass. 463, 470, 35 N.E.2d 672,675 (1941).
>
> This is the general rule. However, it is not an absolute rule.
>
> 'But the plaintiff is not to be put in a better position than it would have been if the defendant had performed the terms of the lease. The location and character of the demised premises must be considered; and the reasonable cost of repairs, in some instances, would furnish the proper measure of damages while, in other instances, the value of the premises may be such that the incurrence of expense for repairs would not be a reasonable, practical or economic method of dealing with the property. Such expense might greatly exceed any diminution of the fair market value of the land that was caused by the defendant's nonperformance of the provisions of the lease.' *Ibid.*
>
> Cost of repairs is merely a convenient way to quantify the damage a lessor has suffered. Where the facts indicate that cost of repairs is unrelated to lessors' actual damage, the rule is not applied. *Pennsylvania Cement Co.* v. *Bradley Contracting Co.*, 11 F.2d 687,688 (2d Cir. 1926) (L. Hand, J.).

'In an action for breach of contract, as opposed to a suit sounding in specific performance, the lessor is entitled only to the damages that were caused to the property by the failure to restore. Where the expense of restoration exceeds the diminution in the market value of the property caused by the lessee's nonperformance, the diminution in fair market value is the proper measure of damages.' *Dodge Street Building Corp.* v. *United States*, 341 F.2d 641,644, 169 Ct.Cl. 496 (1965).

If the 'cost of repair' rule will give lessors a greater benefit than could be gained from full performance, a different measure of damages must be applied to avoid injustice. *Peevyhouse* v. *Garland Coal & Mining Co.*, 382 P.2d 109,113 (Okla. 1963). *Accord, Giordano* v. *Brandywine Mushroom Corp.*, 32 Pa.Dist. & Co. R.2d 522,525–26 (1963). *And see Realty Associates* v. *United States*, 138 F.Supp. 875, 134 Ct.Cl. 167 (1956).

Our purpose in showing the interrelationship between *cost of restoration* and the *cost of repair* is to show that plaintiff assuredly cannot be "taken by surprise" by our holding that cost of repair recoveries are limited by the diminution in fair market value ceiling. The issue was squarely before plaintiff at all stages of the trial, as was the line of cases we have cited.

Therefore, in spite of plaintiff's arguments to the contrary, we find no persuasive reason that repair costs should not be, as restoration costs are, subjected to a ceiling of the diminution in value.

The importance of this rule is accentuated by the peculiar facts in the case at bar. The trial judge found that the plaintiff's difficulty in ultimately selling or re-leasing the property after the Government's tenancy was due in part to factors other than the damage which is the subject of this suit.[6] Missouri Baptist was in a deteriorating area of St. Louis, and was continually subjected to acts of vandalism. If for the moment we assume that the value of the property was greatly diminished by these and other outside factors, then perhaps the diminution in value, if any, *due to the Government's breach* was comparatively small, accentuating the windfall nature of a "cost of repair" recovery.

[6] *See* note 4, *supra*. Plaintiff did not except to this finding. *See* Rule 143(d).

We hold that repair costs are subjected to a ceiling. That ceiling is the diminution in fair market value attributable to defendant's breach.

II.

The Government argues that at trial, plaintiff failed to prove, by a preponderance of the evidence, that the fair market value of the premises was diminished by the Government's failure to abide by the terms of the lease. The Government notes that it provided an expert witness at trial who testified that the fair market value of the premises on the "day in" (June 24, 1966) was zero. This same expert witness testified that the fair market value of the premises on the "day out" (January 31, 1970) was zero. Unrebutted, argues the Government, the zero evidence for both "day in" and "day out" leaves no room for any diminution in fair market value, so plaintiff's recovery should be zero.

The Government cites *Dodge Street Building Corp.* v. *United States*, 169 Ct.Cl. 496,501, 341 F.2d 641,645 (1965) to demonstrate that plaintiff failed in its burden at trial and should thereby be denied recovery:

> . . . it was incumbent upon plaintiff to establish by a preponderance of the evidence that the fair market value of the building in the condition in which defendant had convenanted to restore it, was greater than its fair market value in an unrestored state at the termination of the lease.

This case stands for the clear proposition that when plaintiff comes to trial, he bears a dual burden. He *must* first of all show what the cost of restoration (in this case, cost of repair) is. Thereafter, in order to benefit by the full measure of cost of repair, plaintiff must show that the diminution in fair market value exceeds the cost of repair.[7]

[7] Put simply, plaintiff must show that he was damaged. To require the defendant to expend great sums of money to repair the building, if the damage to the value of the building was *de minimis*, is to work an injustice. For example, a tiny scratch on a picture window might be repairable only by replacing it at great expense, yet the actual damage (the diminution in fair market value of the window) would clearly be trivial. A measure of damages granting full replacement cost of a new picture window would be patently unfair and result in a windfall recovery.

In any event, recovery based on the cost of repairs is subject to an absolute ceiling of "diminution in fair market value." Here, plaintiff only carried half its burden. Cost of repairs were shown in considerable detail. Diminution in value was virtually ignored. Plaintiff simply failed to meet and carry its burden of proof.

However, the Government did not ignore the two-fold burden. Defendant steadfastly maintained its "diminution in fair market value ceiling" argument.

The trial judge wrongly decided that diminution in fair market value was not a determining factor in awarding damages. However, the plaintiff was well aware of the Government's theory of the case. Had the trial judge ruled properly in this regard, plaintiff could have lost the case on insufficiency of evidence. At the very least, plaintiff should have laid the basis for protecting its case on appeal. As will be discussed fully, *infra*, plaintiff did not introduce sufficient evidence to support a finding of fact on fair market value of the property for either the day in or the day out. Plaintiff further did not except to Finding 22(c)[sic][d] as required by Rule 143(d). Finding 22 (c)[sic][d] stated in part:

> There is no convincing evidence in the record on which one could reasonably determine what the fair market value of the Hospital property was in June 1966 or in January 1970.

Further, at oral argument, the plaintiff never availed itself of the opportunity to request submission of supplemental briefing or affidavits (showing fair market value) even after it became apparent that the court was gravely concerned about the relative absence of plaintiff's evidenciary showing. Finally, plaintiff never even pressed the court to consider remanding the case to the trial judge for further evidenciary proceedings on the diminution in fair market value issue.

In the case at bar, the Government introduced market value evidence which should have made it clear to plaintiff

[8] The Government, by arguing and offering evidence of zero fair market value, does not imply that there existed either no salvage value, or no value for the land on which Missouri Baptist was situated. Salvage and land value diminution, however, are not the subject of this suit. The subject matter of this suit is the diminution of fair market value of the Hospital.

that its theory was the diminution in value ceiling, and yet plaintiff—aware that were the Government correct, plaintiff would not have met its burden—did not provide appropriate evidence to protect its case. Plaintiff was on notice.[8] Since it plainly could have introduced evidence to "cover" itself in case the Government's theory proved to be correct, and chose not to do so, we do not feel constrained to remand the case for further findings, thus giving plaintiff a "second bite at the apple."[9]

We now turn to an analysis of the evidence of diminution in fair market value received in this case.

The evidence the Government introduced was opinion evidence of Arthur C. Schneider, a real estate appraiser. Mr. Schneider testified from a report he prepared November 19, 1974 that on the "day in," the fair market value of the property was zero. Mr. Schneider further testified that on the "day out," the fair market value of the property was, again, zero.

Mr. Schneider (hereafter Mr. Schneider, Jr.) had visited the site in July 1966 with his father (hereafter Mr. Schneider, Sr.). Mr. Schneider, Sr. had been hired to appraise the property pursuant to the Economy Act, 40 U.S.C. §278a (1970). The rental figure agreed to by the parties had to be less than 15% of the appraised fair market value. Mr. Schneider, Jr. once again visited the site in August 1969, this time as an appraiser (as versus an observer, as was his position in July 1966) for a private concern.

To capsulize, Mr. Schneider, Jr.'s opinion evidence of zero value at "day in" was based upon his eight-year-old recollections of conditions existing when he accompanied his father in 1966. His finding of zero value

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[9] At this point, it may be worth noting that plaintiff alleged in its initial petition that the leased premises were diminished in value by $1 million, and that the Government was liable therefor. Plaintiff states in its final brief that the trial judge "rejected plaintiff's damage claims based on diminution in value and chose to find damages based on repair cost, [and] plaintiff has now elected to accept damages measured by such repair cost." (Plaintiff's Reply Brief, p. 13). This can only provide further indication that plaintiff understood the nature of the conflict between its damage theory and the Government's. It originally, in its initial petition, *sought damages based on diminution in value*, and yet introduced no valid evidence in this regard.

on "day out" was based on his own appraisal (five months prior to "day out").

The plaintiff relies on Mr. Schneider, Sr.'s 1966 appraisal of $1.2 million, (Government's exhibit # 1) to evidence value on "day in." It relies on a letter evidencing a possible $500,000 offer in 1969 for the property to show evidence of value on "day out."

Considering first the conflicting "day in" evidence, it appears to us that the trial judge correctly determined that the evidence was inconclusive.

First, Mr. Schneider, Jr.'s zero value evidence is, according to the trial judge's Finding 22b, "based on his July 1966 site visit and utiliz[ed] a lot of the data contained in his father's appraisal report." Mr. Schneider's 1974 report then is based on memory of events eight years past, and though using Mr. Schneider, Sr.'s data, comes out with a glaring discrepancy in appraised value.

Mr. Schneider, Sr. determined the fair market value to be $1.2 million. The trial judge found this $1.2 million figure unreliable. As Trial Judge Lydon points out, the Economy Act, 40 U.S.C. § 278(a)(1970) provides:

> . . . any rental cost to be reimbursable to Delta could not exceed 15 percent of the fair market value of the rented premises. The qualified appraiser, deceased at the time of trial, was of the opinion the property had a fair market value of $1,200,000. This rounded-off figure consisted of $1,172,949 for the improvements and $48,800 for the land. The evidence of record fails to persuade that this opinion represents a reasonable indication of the fair market value of the building and property in July 1966. The appraisal was made specifically for the purpose of supporting a rental figure which, to be reimbursable, must fall within a certain range. Further, the basis for the value opinion on the improvements was not comparable sales but depreciated reproduction costs, a most unsatisfactory fair market value approach. *See Schoeffel* v. *United States*, 193 Ct.Cl. 923,936 (1971). *See also, Westchester County Park Commission* v. *United States*, 143 F.2d 688,693 (2d Cir. 1944), *cert. denied*, 323 U.S. 726. Accordingly, there is no reliable evidence in the record as to the fair market value of the old building in June—July 1966. (Trial Judge Opinion at 17–18, n.4)

This quote shows that despite the theoretical correlation between the 1966 opinion of the appraiser and the rental payments, the actual fair market value may well have been significantly less.

Based upon Mr. Schneider, Jr.'s appraisal which we feel may be flawed due to the passage of time and the related potential lapse in memory, the glaring discrepancy in values grounded on much of the same raw data (as contained in Mr. Schneider, Sr.'s report) and the problems with Mr. Schneider, Sr.'s opinion itself, we agree that no reasonable determination of fair market value on the "day in" can be gleaned from the record.

Turning now to evidence of fair market value at "day out," we have Mr. Schneider, Jr.'s appraisal of zero value presented by the Government, and the letter evidencing a possible offer of $500,000 in 1969 presented by the plaintiff.

Mr. Schneider, Jr.'s appraisal for "day out" is not subjected to the same infirmity which weakens his "day in" appraisal. Here, the appraisal was his *own*, performed at a date near the actual "day out."

The trial judge relied on a letter in the record to dispute Mr. Schneider's testimony concerning zero value on "day out." Unfortunately, the letter was wrongfully received and wrongfully used. In Finding 12a the trial judge finds that the Board of Trustees of the Hospital received a letter from Edward L. Presnell which essentially stated that Mr. Presnell had a client who "*may* still be interested in offering $500,000 all cash . . ." for the property. (emphasis added) This evidence, in its present form, is inadmissible to establish value. In *Sharp* v. *United States*, 191 U.S. 341,349 (1903), the Supreme Court concisely stated the reasons why offers (such as this one, and Presnell's letter does not even rise to the dignity of an offer) are not admissible to establish value:

> It is frequently very difficult to show precisely the situation under which these offers were made. In our judgment they do not tend to show value, and they are unsatisfactory, easy of fabrication and even dangerous in their character as evidence . . .

Since the letter was inadmissible to determine fair market value, it was both improperly admitted and

improperly used as a countervailent to Mr. Schneider's testimony concerning zero fair market value at the "day out."

We therefore find, based on the record in this case, that Mr. Schneider's evidence of zero value on "day out" is not contradicted. We are satisfied that the fair market value on day out *was* zero, and so find.

We note at this point that "zero value at day out" could have been found by the trial judge. In view of this possibility, we are further at a loss to see why plaintiff at least did not present evidence of his own for a fair market value at "day in." Had there been any credible proof of "day in" fair market value, when compared with zero value "day out" finding, at least *some* recovery might be allowed. In fact, were the "day in" value (discounting vandalism and ordinary wear and tear) higher than the cost of repairs in this case, a full cost of repair recovery could have been allowed. It must be remembered, that if the "diminution in fair market value" attributable to the breach exceeds the "cost of repair" measurement of damages, the entire "cost of repair" may be awarded. In any event, "cost of repair" damages are the maximum recovery one can receive, regardless of the diminution in value (*See*, "watch example," *supra* at 512).

Plaintiff, at oral argument, said:

> . . . [T]he reason why plaintiff did not attempt to produce an appraiser to say what this building was worth at the beginning of the lease and what it was worth at the end of the lease was that the beginning of the lease was some four years prior to the termination date in January 1970. And we felt that no appraiser could get on a witness stand and competently testify that this building had X value back in 1966. And we also cross-examined the Government's witness quite heavily on this same issue, particularly since the individual had not even attempted to appraise it but had been with his father on an inspection tour back in 1966. At the time that we talked to appraisers there was no building left to appraise. And for the same obvious reason you can't ask an appraiser to get on the witness stand and say this building was worth X dollars on such and such date if no building was there to appraise . . . . impossible burden . . . .

We are not persuaded by plaintiff's argument. It is a common occurrence for appraisers to give opinions even where the appraised property no longer exists, using such indices as sales of other property in the neighborhood, etc. We find no persuasive excuse for plaintiff's failure to have carried his burden of proof. *Dodge Street Building Corp., supra.*

We are thus left with the following situation: Plaintiff has failed to carry its burden of proof at trial. The trial judge properly found no conclusive evidence of value on "day in;" we find a zero fair market value on "day out." Plaintiff, by failing to except to the trial judge's finding of no evidence of value (it could have excepted saying Mr. Schneider, Sr.'s $1.2 million appraisal was conclusive) cannot contest the finding. Rule 143(d). *See, General Electric Co.* v. *United States,* 189 Ct.Cl. 116,118, 416 F.2d 1320,1322 (1969). Plaintiff never pressed for a remand, never offered to file supplemental briefs or affidavits, or even attempted to except to the finding at as late a stage as oral argument.

The court also notes at this juncture that the case for denying plaintiff "remand relief" is very strong here. It has been held in *S.O.G. of Arkansas* v. *United States,* 212 Ct. Cl. 131(1977):

> Where a new subject is brought into the case by questions at oral argument [and in the case at bar, the "diminution in value" theory was hardly new] a party which feels that the record or briefing as they stand, inadequately present its position on that matter shall so inform the court at the argument or promptly thereafter. *Citing General Electric Co.* v. *United States,* 189 Ct.Cl. 116,117–18, 416 F.2d 1320,1321–22 (1969).

We therefore hold that plaintiff failed to carry its burden of proof.

This concludes our discussion of the major issues raised by the parties. We now turn to issues raised in the various counterclaims of the parties. Since we hold that the trial judge properly decided them in Part III of his opinion, we adopt that portion. It follows hereafter:

OPINION OF THE TRIAL JUDGE

Lydon, *Trial Judge:*

Part III

Defendant's first counterclaim is based on the following pertinent provisions of the *Repair and Maintenance* clause (Article XIII) of the lease:

> * * * Repair costs for a single undertaking exceeding One Thousand Dollars ($1,000.00) shall be deemed a major repair and the costs thereof in excess of One Thousand Dollars ($1,000.00) shall be born [sic] by the Lessor. In no event shall the Lessor be required to pay more than Five Thousand Dollars ($5,000.00) for any twelve (12) month period of the lease. Any repairs costing in excess of said amounts (aggregating Six Thousand Dollars ($6,000.00)) within any twelve (12) month period of the lease, will be at the sole expense of the Lessee.

Defendant contends that in three separate 12-month periods, defendant (or Delta as assignor lessee) incurred major repair costs in excess of $6,000. During these three 12-month periods, defendant alleges plaintiff failed to meet the obligations placed on it by the above-quoted provision of the lease, *i.e.*, paying for its share of major repair costs, such that it is now indebted to defendant in the sum of $13,478.71 for breach of said lease requirement. The three 12-month periods in question were: (1) July 1, 1966—June 30, 1967; (2) July 1, 1968—June 30, 1969; and (3) July 1, 1969—January 31, 1970. It is significant to note that plaintiff paid Delta $5,000 under the above-quoted lease provision for repairs made by Delta during the period July 1, 1967—June 30, 1968. It is important to keep in mind that the provision, *supra*, concerns "Repair costs" and does not embrace other nonrepair-type costs incurred by Delta.

During the period July 1, 1966—June 30, 1967, Delta incurred costs of some $22,484.54. These costs involved painting the exterior of the building and performing work relating to heating, air conditioning, elevators and plumbing. Delta made no request of plaintiff for cost contribution under the provision of the lease under consideration. This failure of Delta to request cost contribution generates an inference that said costs were not considered "Repair costs" contemplated by the lease provision in issue. This

inference has support in the fact that in the follow-on period, July 1, 1967—June 30, 1968, Delta, when it incurred "Repair costs" considered to be within the purview of the lease provision, billed plaintiff for cost contribution under said lease provision and was paid by plaintiff. These costs in the total amount of $8,246 involved *repairs* (emphasis supplied) to walk-in refrigerators, heat exchange and exterior brick walls of the building. Further, in February 1969, plaintiff advised Delta that under the lease provision in question "repair costs * * * was intended to mean major repair and not operating maintenance." Neither Delta nor defendant disputed this interpretation at any time. Defendant has not disputed this interpretation in its brief.

During the period July 1, 1968—June 30, 1969, Delta incurred repair costs of $9,258. Delta billed plaintiff in April 1969 for $5,000 representing its cost contribution relative to said repairs under the lease provision in question. The record is most unsatisfactory on the matter, but warrants an inference that plaintiff paid this sum as billed. This inference is supported by the fact that the financial activities of Delta were closely audited by the Defense Contract Audit Agency, through its auditor Lee Newberry. He received a carbon copy of the invoice that Delta sent to plaintiff billing it for $5,000 as cost contribution. Newberry testified as a witness in this case and while he was not questioned specifically about whether or not payment had actually been received by Delta relative to the April 1969 billing, his responsibility to protect the government's interests relative to all costs incurred by the Job Corps center suggests that had some costs, as invoiced, not been paid by plaintiff, Newberry would have surfaced such a fact as part of his audit responsibilities.*

* Plaintiff, in any event, questions defendant's right to claim costs incurred by Delta and allegedly due and owing Delta by plaintiff prior to assignment, effective July 1, 1969, of the lease by Delta to defendant. The case relied on by plaintiff in this regard, i.e., *Standard Live Stock Co.* v. *Pentz*, 204 Cal. 618, 269 P. 645 (1928), can also be read to support defendant's right to make the disputed claim it advances herein. However, it is not necessary to resolve this question in view of the disposition of the claim on other grounds.

During the period July 1, 1969—January 31, 1970, Labor incurred costs of $6,478.71 applicable to work performed on elevators, sprinkler system and plumbing. Labor made no request for contribution by plaintiff under the lease provision, *supra*, relative to these costs. It is noted these costs are somewhat similar to costs incurred during the July 1, 1966—June 30, 1967, period for which Delta made no claim for contribution. The failure of Labor to bill plaintiff for these costs supports an inference that said costs were considered by it to be operating maintenance costs and not repair costs and thus beyond the pale of the lease provision in question.

The record will not support recovery by defendant of $13,478.71 under its first counterclaim.

Defendant's second counterclaim, filed just before trial in this case in January 1975, although its answer had been filed on February 25, 1972, is grounded on the provisions of Article XXIII, *Additional Rent*, of the lease, as supplemented. This Article also serves as the basis for plaintiff's claim for additional rent payments. Article XXIII provided in pertinent part as follows:

> In addition to the provisions contained in Section II. of the original lease, Lessee shall pay to Lessor an additional yearly rental in the sum of Thirty Thousand Dollars ($30,000.00), to be paid in monthly payments of Twenty-Five Hundred Dollars ($2500.00) each, commencing at the same time as provided for rent payments in Section II. Such additional rent shall be for the purpose of reimbursing Lessor for real estate taxes, assessments and improvement liens paid upon the leased premises by Lessor. Should the total sum of all real estate taxes, assessments and improvements liens be less than Thirty Thousand Dollars ($30,000.00) annually, the Lessor will pay back the difference between the total sum of such taxes, assessments and improvement liens and Thirty Thousand Dollars ($30,000.00) to the Lessee, and an accounting for same and repayment shall be on or before the 15th day of January of each year. In no event shall the Lessee be required to pay or reimburse Lessor a sum greater than Thirty Thousand Dollars ($30,000.00) annually, for any real estate taxes, assessments, and improvement liens levied or imposed upon the leased premises.

Real estate taxes for 1969 on the leased property amounted to $23,138.21. Delta and/or Labor paid $20,000

(8 × $2,500), as invoiced by plaintiff, covering rental payments under Article XXIII for the months of January through August 1969. It is to be remembered that the lease was to expire by its terms on August 31, 1969. Effective September 1, 1969, plaintiff and Labor agreed to continue the lease on a month-to-month basis and also agreed to certain rental payment changes, which will be discussed, *infra*.

Defendant maintains that since it was required only to pay the real estate taxes for 8 of the 12 months of 1969, it should only be responsible for two-thirds of the total real estate taxes paid for the year ($23,138.21), or $15,425.47. Since it paid $20,000, it claims by way of its second counterclaim the difference ($20,000—$15,425.47) or $4,574.53.

Plaintiff, by way of a belated claim, asserted after the case had been tried, on the assumption of conforming the pleadings to the proof, seeks to recover an additional $3,138.21, representing the difference between the total real estate taxes paid for 1969 and the $20,000 it received from Delta and/or Labor during said year as additional rental.

There was no meaningful testimony at trial as to the construction, scope and reach of paragraph XXIII of lease. Indeed there was absolutely no evidence at all as to how the real estate tax situation was handled by the parties for the years 1966, 1967, and 1968. Paragraph XXIII of the lease specifically provided that an accounting was to be had for all real estate taxes paid and a repayment, if such be deemed necessary, was to be had on or before the 15th day of January of each year. Since there was no accounting had by and between the parties on or before January 15, 1970, or at any time thereafter, and no repayment was sought by either party within that period, it is not unreasonable to conclude that both parties contemporaneously, and before the matter was subjected to litigation, interpreted paragraph XXIII as requiring the $2,500 additional monthly rental payments by defendant for the 8 months in question. This conduct on the part of the parties is more revealing than the dry language of Article XXIII by itself. *Macke Co. v. United States*, 199 Ct. Cl. 552, 556, 467 F.2d 1323, 1325

(1972). It is also noted that the paragraph made no provision for prorating the real estate taxes paid for a tenancy of less than 12 months, said paragraph speaking in terms of a yearly rental obligation of $30,000, to be paid in monthly payments of $2,500, with the repayment of any sum to Delta and/or Labor to represent the difference between $30,000 and the total sum of the real estate taxes paid. The situation in question does not fit squarely within the language of paragraph XXIII and thus the lack of an accounting and any request for repayment within the time frame of the paragraph itself, weighs heavily in the conclusion reached herein since the record offers no other evidence which bears on the matter. Defendant has made no persuasive argument, either factually or legally, which would justify granting it recovery on its second counterclaim.

What has been said above also serves to require denial of plaintiff's claim for additional rental payments for 1969. Moreover, other facts of record support this conclusion. Effective September 1, 1969, plaintiff and Labor renegotiated the rental payments to be thereafter made by Labor. It was agreed that the rental for September 1969 would be $10,416.66, and thereafter, commencing October 1, 1969, the monthly rental would be $5,208.33. There was no mention made, in discussion or in correspondence between the parties at any time, relative to payment by Labor for September 1969 and succeeding months of an additional rental payment of $2,500, or any amount whatsoever, for real estate tax purposes. The testimony of plaintiff's witnesses does not support any such claim. Further, plaintiff's conduct during the period September 1969—January 1970 clearly indicates that defendant was not obligated to pay additional rental for real estate tax purposes. Prior to September 1969, plaintiff in billing Delta and/or Labor specifically invoiced for additional rental for real estate tax purposes. In its billings to Labor for September 1969 and thereafter, plaintiff significantly did not include in the invoices any claim for additional rental for real estate tax purposes. This conduct convinces that the parties did not intend that real estate taxes would be paid, as additional rental, by Labor to plaintiff during the

period September 1969 and thereafter. *See Max Drill, Inc.* v. *United States*, 192 Ct. Cl. 608, 620, 427 F.2d 1233, 1240 (1970); *Universal Match Corp.* v. *United States*, 161 Ct. Cl. 418, 422 (1963).

In view of the above discussion, neither party is entitled to any recovery premised on Article XXIII of the lease.

SUMMARY

In summary, we hold the trial judge to have erred in determining damages based solely on a *cost of repair* analysis without regard to a *diminution of fair market value* ceiling. Plaintiff's reliance on a possible distinction between *cost of repair* and *cost of restoration* is unfounded in view of the similarity in treatment of the two methods in the cases, and because the rationale of the rule as applied to *cost of restoration* cases (i.e., avoidance of windfall recovery) is equally applicable to *cost of repair* cases. We further hold that the burden of proof plaintiff is required to bear was not met. In addition to a showing of what the costs of repair would be, plaintiff also needed to demonstrate whether the *diminution in fair market value* measurement exceeded the *cost of repair* measurement. If plaintiff cannot show an excess of *diminution in fair market value* over *cost of repair*, his damages will be measured solely with regard to the diminution in value attributable to the Government's breach. In this case, we agree with the trial judge that there is no adequate and conclusive evidence indicative of a fair market value on "day in." However, from an examination of the record, we find the fair market value of the property on "day out" to have been zero. The trial judge erred in discounting the "zero value" appraisal by wrongfully receiving and wrongfully applying a letter ostensibly showing a "possible" offer of $500,000 for the property. Evidence of an offer is inadmissible to prove fair market value.

Additionally, plaintiff failed to except to the trial judge's finding of "no convincing evidence" as to fair market value on "day in" and "day out." This is inconsistent with Court of Claims Rule 143(d). Having also failed to file supplemental briefing and/or affidavits, or even to press for a remand

of proceedings, plaintiff has not postured itself in such a manner as to merit recovery.

NICHOLS, *Judge,* concurring:

I join in the judgment and in Judge Kunzig's persuasive opinion, though I was originally of another view. However, I do not believe, and do not understand the opinion to say, that covenants in leases to deliver the leased premises to the lessor in good condition at the end of the lease period, reasonable wear and tear excepted, are always and invariably nullities if the property had no fair market value at the beginning of the lease and at the end. If this were true, it would have consequences the court might not desire. There is, undoubtedly, at the present time, a great deal of "improved" urban real estate, that would be found on an unbiased appraisal to lack any fair market value. Owners may have reasons for wishing to preserve their property, perhaps a hope for better times, perhaps other considerations. They may want to have the property in possession of a responsible tenant rather than vacant and more fully exposed to vandalism, which even occupancy, in our state of urban decadence, no longer entirely guards against. In view of the decision we are making, the question might arise, how are they to require the lessee actually to keep the premises in good physical repair, market value consideration aside? Obviously they could spell it out. Should they fail to do so, such covenants might be implied from the attendant circumstances. Words in leases, as in other contracts, cannot always be given the same unvarying meaning.

If it appeared, for example, that the property was historic and destined, eventually, to become part of a restored historic section, as in Alexandria, Virginia, the parties might have so plainly covenanted with that consideration in their minds, that the conventional restoration language would have a different meaning.

While it was virtually impossible to show here, that the property had any fair market value at the beginning of the lease, the parties originally contracted with reference to an appraisal that indicated it did. This may have been, as the trial judge intimates, little better than an agreed fiction,

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but still it rebuts the idea one might otherwise entertain, that they contracted with a purpose to disregard market value considerations in their relations as landlord and tenant. In such circumstances it would be absurd to mulct the Government for not effecting repairs that would have been useless so far as their effect on market value was concerned. The trial judge's decision would have presented the hospital trustees with a mere windfall, where it looks as if they were fortunate indeed to derive the income they did from such worthless property, before the instant claim arose.

CONCLUSION OF LAW

Upon the foregoing opinion, and the findings of fact of the trial judge as modified, which are hereby adopted but not printed, the court concludes that plaintiff is not entitled to recover any damages. The court also concludes that defendant's two counterclaims, and plaintiff's belated claim must fail. The petition and the counterclaims are dismissed.

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553 F.2d 667

ELIZABETH B. JONES, AS EXECUTRIX OF THE ESTATE OF CARL T. JONES, DECEASED v. THE UNITED STATES

[No. 160–74. Decided April 20, 1977. Plaintiff's motion for rehearing denied June 24, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; income tax; distributions by partnership; election to adjust basis of partnership property; timeliness of election.—Decedent, who died in October 1967, was a partner in three firms. The partnership income tax returns for calendar years 1967 and 1968 did not contain an election under Sec. 754 of the Code to adjust the basis of partnership property under Secs. 734(b) or 743(b). Elections were filed on August 20, 1969 by the then-existing partnerships. Decedent's estate timely filed fiduciary income tax returns for fiscal years October 31, 1968, 1969 and 1970, claiming additional depreciation deductions on assets held by the partnerships attributable to the estate taking a stepped-up basis in the

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partnership property, i.e. cattle and real estate. The IRS disallowed the said additional deductions, determined that the Sec. 754 elections were not timely filed based upon Treas. Reg. § 1.754–1(b), and assessed tax deficiencies for said fiscal years. The deficiencies and assessed interest were paid, and in this suit the estate seeks refund thereof, plus statutory interest. Plaintiff contends that the partnership elections filed in August 1969 were in accordance with the statute and are valid retroactively to the year ending December 31, 1967, that the regulation is unreasonable and punitive in nature, and that if the court finds the elections not retroactive to 1967 the elections should be valid for those years subsequent to the filing thereof entitling plaintiff to use a stepped-up basis in the partnership assets. It is *held* that the regulation is not inconsistent with the statute; that the partnership failed timely to elect an optional adjustment to basis in the partnership property for the year 1967; that with relation to the 1967 transfer the elections filed in 1969 were not effective as to partnership year 1970 and subsequent years; and that plaintiff is not entitled to use a stepped-up basis in the partnership assets. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted and the petition is dismissed.

Taxes; income tax; distributions by a partnership; election to adjust basis of partnership property; consistency between statute and regulation.

[1] Where Congress expressly granted the Secretary of the Treasury authority to prescribe regulations governing the manner of electing optional adjustment to basis of partnership property pursuant to Sec. 754 of the Code, the requirement in Treas. Reg. § 1.754–1(b) that the election shall be made in a written statement filed with the partnership return for the taxable year during which the distribution or transfer occurs is not inconsistent with the statute and is supported by the legislative history of Sec. 754.

Internal Revenue ⚖1355

Taxes; income tax; distributions by a partnership; election to adjust basis of partnership property; timeliness of election.

[2] Where the subject partnerships did not elect an optional adjustment to basis of partnership property as provided in Sec. 754 and implementing regulations, for the year when decedent-partner died, either in the original returns or by amended returns filed within the statutory time for filing the original returns, decedent's estate is not entitled to use a stepped-up basis in the partnerships' assets in computing its distributive share of income from the partnerships.

Internal Revenue ⚖1355

Taxes; income tax; distributions by a partnership; election to adjust basis of partnership property; election subsequent to year of distribution.

[3] Where the transfer of partnership interests was occasioned by the death of a partner in 1967 and a timely election was not filed pursuant to Sec. 754 for the partnerships' taxable year 1967, a Sec. 754 election for taxable year 1970 is inoperative to entitle decedent's estate to use a

stepped-up basis in the partnership assets for 1970 and subsequent years.

Internal Revenue ⇐1355

Louis Salmon, attorney of record, for plaintiff. *Watts, Salmon, Roberts, Manning & Noojin*, of counsel.

Kenneth R. Pike, with whom was *Acting Assistant Attorney General Myron C. Baum*, for defendant. *Theodore D. Peyser* and *Robert S. Watkins*, of counsel.

Before DAVIS, SKELTON and KASHIWA, *Judges*.

KASHIWA, *Judge*, delivered the opinion of the court:

This tax refund action involving the timeliness of an I.R.C. § 754 election to adjust the basis of partnership property as provided by I.R.C. § 743(b) is properly before the court on cross motions for summary judgment.[1] Upon consideration of each party's brief with Stipulation of Facts, after oral argument, we agree with the defendant that the decedent's estate in computing its distributive share of income from two partnerships in which decedent was interested is not entitled to use a stepped-up basis in the partnership assets. The partnerships failed timely to elect the basis adjustment in the returns filed for the taxable years of the partnerships in which decedent's partnership interests were transferred to his estate upon his death. We, therefore, allow defendant's cross motion for summary judgment.

Decedent, Carl T. Jones, died on October 7, 1967. At the time of his death, decedent was a partner in three firms located in Huntsville, Alabama: G. W. Jones & Sons; Carl T. Jones and Raymond B. Jones; and Jones, Ryan & Blackwell.

At the time of decedent's death, no election under § 754[2] to adjust the basis of partnership property under §§ 734(b)

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954.

[2] SEC. 754. MANNER OF ELECTING OPTIONAL ADJUSTMENT TO BASIS OF PARTNERSHIP PROPERTY.

"If a partnership files an election, in accordance with regulations prescribed by the Secretary or his delegate, the basis of partnership property shall be adjusted, in the case of a distribution of property, in the manner provided in section 734 and, in the

or 743(b) was in effect for any of the above-named partnerships.[3]

The three partnerships, each on a calendar year basis, timely filed income tax returns for the calendar years 1967 and 1968. These returns did not contain an election under §754, nor was there on or attached to these returns a special depreciation schedule attributable to decedent's interests in the partnerships. All partnership depreciation schedules were regular continuations of original cost amounts with no reference to the death of Carl T. Jones.

The Estate of Carl T. Jones succeeded to decedent's partnership interests. The estate retained a member of the Appraisal Institute to appraise the real property of the three partnerships. The appraisals, dated August, September, October and December 1968, valued the total real estate holdings, about 63 parcels, at $3,508,745.55. The appraised values of the real property were used in the estate tax return for the Estate of Carl T. Jones, which was filed on January 6, 1969.[4]

On August 20, 1969, a § 754 election to adjust the basis of partnership property under §§ 734(b) and 743(b) was filed by the two then existing partnerships, G. W. Jones & Sons and Carl T. Jones and Raymond B. Jones.[5] The election, which did not accompany either a partnership return or an amended return, indicated it was to apply to the calendar

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case of a transfer of a partnership interest, in the manner provided in section 743. Such an election shall apply with respect to all distributions of property by the partnership and to all transfers of interests in the partnership during the taxable year with respect to which such election was filed and all subsequent taxable years. Such election may be revoked by the partnership, subject to such limitations as may be provided by regulations prescribed by the Secretary or his delegate."

[3] The basis of partnership assets is not affected by the death of a partner. To be consistent with the concept that property owned by a decedent receives a stepped-up basis equal to its fair market value at the date of death or at the optional valuation date (§ 1014(a)), § 754 permits the partnership under § 743 an elective adjustment to the basis of the partnership property. This adjustment will affect the basis of the partnership assets only for the heir of the deceased partner and not for the other partners. However, if the partnership does not make the election, an heir's basis for partnership assets remains the same as the partnership's and is not increased to reflect the higher estate tax value of the inherited partnership interest.

[4] On audit the Internal Revenue Service accepted the estate's appraised whole values of the partnerships' real property, although the Internal Revenue Service made certain adjustments concerning discounts which were accepted by the estate.

[5] The partnership of Jones, Ryan & Blackwell had been dissolved by agreement on May 16, 1969.

year 1967 and each subsequent year. Between October 7, 1967, decedent's date of death, and August 20, 1969, the date on which the elections were filed, no extension of time to file an election under § 754 was ever requested by or granted to the partnerships or the estate.

The Estate of Carl T. Jones timely filed fiduciary income tax returns for the fiscal years October 31, 1968; October 31, 1969; and October 31, 1970. By schedule attached to each return, the estate claimed additional depreciation deductions on assets held by the partnerships of Carl T. Jones and Raymond B. Jones and G. W. Jones & Sons; it also claimed additional deductions for increased basis in partnership assets—cattle—which were sold by G. W. Jones & Sons. These additional deductions were attributable to the estate taking a stepped-up basis in the partnership property.

The Internal Revenue Service, upon audit of the estate's fiduciary income tax returns, disallowed the additional deductions attributable to the adjustments to basis of the partnership property. The Service determined that the § 754 elections were not timely filed based upon Treas. Reg. § 1.754–1(b) and assessed income tax deficiencies totaling $43,363.86 for fiscal years ended October 31, 1968, 1969 and 1970. The plaintiff made payments of the assessed deficiencies, plus interest, totaling $50,937.22, to the Internal Revenue Service. The estate filed timely claims for refund; after such claims were not acted upon by the Internal Revenue Service for more than six months after the date of filing, the estate filed the instant suit.

Basically, plaintiff contends that Treas. Reg. 1.754–1(b) did not give the partnerships a sufficient amount of time to appraise the numerous parcels of real property which appraisals would afford the partnerships the facts to make an intelligent decision whether to elect the optional adjustment to basis of partnership property. To plaintiff the regulation is "patently unreasonable and clearly punitive in nature," is "out of harmony with the statute," and "as such is a nullity and void." Therefore, plaintiff argues, the elections filed by the partnerships were in accordance with the statute and are valid retroactively to the year ending December 31, 1967. Alternatively, plaintiff

contends that if the court finds the elections not retroactive to the partnerships' taxable year 1967, the elections should be valid for those years subsequent to the date of filing, which for those years would entitle plaintiff to use a stepped-up basis in the partnership assets.

On the other hand, defendant argues that pursuant to an express grant of authority contained in § 754, the Secretary promulgated Treas. Reg. 1.754–1(b), which prescribes a reasonable time frame within which a partnership must act to elect the optional basis adjustment. Since the partnerships in which decedent was interested did not make timely elections under § 754, defendant argues that the plaintiff is not entitled to the benefit of an optional adjustment to basis in the partnerships' property. With relation to plaintiff's argument that this court should give prospective effectiveness, if not retroactive effectiveness, to the elections filed on August 20, 1969, the defendant contends that an election which is not valid for the taxable year of the transfer is also not valid for subsequent years.

We are, therefore, confronted with the ultimate question of whether an election under § 754 to adjust the basis of a decedent's interest in partnership assets was valid when filed on August 20, 1969, rather than by April 15, 1968, when the first partnership return was due to be filed for the taxable year of the partnership in which decedent's partnership interests were transferred to his estate. This issue requires that we first examine Treas. Reg. § 1.754–1(b) to determine whether that regulation to the extent of the time filing provision is invalid, *viz.* whether it is inconsistent with the statute upon which it is based or whether it is unreasonable.

The optional adjustment to basis of partnership property on transfer of a partnership interest is specifically conditioned on the filing of an election under § 754.[6] The

[6] SEC. 743. OPTIONAL ADJUSTMENT TO BASIS OF PARTNERSHIP PROPERTY.

"(a) *General Rule.*—The basis of partnership property shall not be adjusted as the result of a transfer of an interest in a partnership by sale or exchange or on the death of a partner unless the election provided by section 754 (relating to optional adjustment to basis of partnership property) is in effect with respect to such partnership."

* * * * *

election applies both to § 734(b), on distribution of partnership property, and to § 743(b), on transfer of a partnership interest. Unless the election is revoked, the § 754 election applies to all distributions and to all transfers of partnership interests made during the year for which the election is made and in all subsequent years.[7]

Congress by § 754 has delegated to the Secretary specific authority to "legislate" in this area.[8] Pursuant to this express grant of authority, in 1956 the Secretary promulgated Treas. Reg. § 1.754–1(b)[9] which provided that the § 754 election to adjust basis had to be filed with the partnership return for the first taxable year to which the election applies. In Rev. Rul. 57–347,[10] the Service stated that the election need not be made before the occurrence of an unforeseen event, such as death of a partner, which would make the election operative. Effective October 2, 1972, the above regulation was amended by T.D. 7208,[11]

SEC. 734. OPTIONAL ADJUSTMENT TO BASIS OF UNDISTRIBUTED PARTNERSHIP PROPERTY.

"(a) *General Rule.*—The basis of partnership property shall not be adjusted as the result of a distribution of property to a partner unless the election, provided in section 754 (relating to optional adjustment to basis of partnership property), is in effect with respect to such partnership."

* * * * *

[7] I.R.C. § 754, see note 2, *supra*.

[8] Congress can and frequently does specifically authorize the Secretary to implement a tax statute by promulgating regulations. We refer to these regulations as "legislative" type regulations, as opposed to "interpretive" regulations.

[9] T.D. 6175, 1956–1 C.B. 211.

§ 1.754–1 *Time and manner of making election to adjust basis of partnership property.*

* * * * *

"(b) *Method of making election.* An election under this section to adjust the basis of partnership property under sections 734(b) and 743(b) shall be made in a written statement filed with the partnership return for the first taxable year to which the election applies (or before August 23, 1956). The statement shall (1) set forth the name and address of the partnership making the election, (2) be signed by any one of the partners, and (3) contain a declaration that the partnership elects to apply the provisions of section 734(b) and section 743(b)." * * *

* * * * *

[10] Rev. Rul. 57–347, 1957–2 C.B. 365.

[11] T.D. 7208, 1972–2 C.B. 396.

§ 1.754–1 *Time and manner of making election to adjust basis of partnership property.*

* * * * *

"(b) *Time and method of making election.* (1) An election under section 754 and this section to adjust the basis of partnership property under sections 734(b) and

which clarified the Service's interpretation of the time for making the election under § 754. As amended, Treas Reg. § 1.754–1(b) provides that the election under § 754 "* * * shall be made in a written statement filed with the partnership return for the taxable year during which the distribution or transfer occurs." There is nothing in the amended regulation to indicate that it is not applicable to the years involved herein.[12] Hence, from 1956 to the present, the position of the Internal Revenue Service consistently has been that in order for the optional basis adjustment election to be effective as to a transferee partner who acquired a partnership interest on the death of a partner, the election must be filed by the partnership with a timely return for the taxable year in which the transfer occurs.

The regulatory requirement that the election to adjust basis of partnership property, to be effective, must be filed for the taxable year of the partnership in which a transfer of an interest in the partnership occurs, finds support in the legislative history of § 754. Section 743 as initially proposed contained a subsection (d) which provided that a partnership could make an election under § 743 by filing a statement of election with its return for the taxable year in which the partnership interest is transferred.[13] The Senate Finance Committee replaced this subsection with the present § 754 and in removing from the statute the specifications for making the election, it authorized the Secretary to promulgate regulations governing the manner of election.[14] As a result, Treas. Reg. § 1.754–1(b), in view of

743(b), with respect to a distribution of property to a partner or a transfer of an interest in a partnership, shall be made in a written statement filed with the partnership return for the taxable year during which the distribution or transfer occurs. For the election to be valid, the return must be filed not later than the time prescribed by paragraph (e) of § 1.6031–1 (including extensions thereof) for filing the return for such taxable year (or before August 23, 1956, whichever is later)." * * *

[12] SEC. 7805. RULES AND REGULATIONS.

"(b) *Retroactivity of Regulation or Rulings.*—The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect."

[13] H.R. 8300, 83d Cong., 2d Sess. (1954).

[14] S. Rep. No. 1622, 83d Cong., 2d Sess. 406 (1954); 3 U.S. Code Cong. & Ad. News 4621, 5048 (1954).

its legislative history, is not "clearly contrary to the will of Congress."[15] Therefore, we do not find that the regulation in issue is plainly inconsistent with the statute.

Nevertheless, the plaintiff asserts that the regulation is unreasonable by requiring that the election be made in the year the transfer upon death occurs, since the value of the partnership interest is not likely to be finally determined in the year of death. In the instant case, plaintiff alleges that the partnerships had insufficient time in which to gather the facts essential for them to make the determination as to whether an election should be made; "as soon as the partnerships had sufficient information to make an informed and intelligent decision that the election was necessary," plaintiff contends that the elections were filed. However, the facts do not fully support plaintiff's contentions.

In the instant case, Carl T. Jones died on October 7, 1967. The partnerships involved herein filed federal income tax returns on a calendar year basis. Their returns for 1967 were due to be filed on or before April 15, 1968, and were timely filed without extension. Thus, the partnerships had over six months to determine whether they wished to file elections under § 754, even without requesting any extension of time.[16] However, it should be noted that the stipulated facts indicate that no requests for extensions of time to file the partnership returns or to make the elections were ever made. In addition, the deductions claimed on the plaintiff's fiduciary income tax returns for the years in suit are of two types—additional basis in cattle sold and additional depreciation deductions on real estate. With respect to the cattle, the plaintiff was able to secure an appraisal within one week of decedent's death. Concerning the additional depreciation deductions, copies of the partnerships' 1967 returns show that the bulk of depreciable assets held by the partnerships had substan-

[15] *Comm'r* v. *South Texas Lumber Co.*, 333 U.S. 496, 503 (1948); *Fawcus Machine Co.* v. *United States*, 282 U.S. 375, 378 (1931).

[16] During oral argument and in its brief in support of its cross motion for summary judgment, the Government informed the court that the initial period for making a § 754 election may be increased not only if the partnership requests and is granted an extension of time to file its return, Treas. Reg. § 1.754–1(b)(1), but also if the partnership requests and is granted an extension of time to file the election.

tially reduced adjusted bases in the hands of the partnerships due to previous depreciation deductions. This should have indicated that a § 754 election might have been beneficial with respect to such depreciable assets. Nevertheless, assuming that a formal appraisal of the partnerships' assets was necessary in order to make the elections, plaintiff has offered no satisfactory explanation as to why the appraisals could not have been completed within six months from decedent's death. Finally, plaintiff's statement that the elections were filed "as soon as the partnerships had sufficient information to make an informed and intelligent decision that the election was necessary" seems erroneous. The initial fiduciary income tax return for decedent's estate was filed on February 10, 1969, and claimed the additional deductions for depreciation and for increased basis in cattle which are here in dispute. Thus, by February 10, 1969, plaintiff clearly had all necessary information and yet, inexplicably, the partnerships did not file elections under § 754 until August 20, 1969. This lapse of six additional months, coupled with the fact that no extension of time to file the partnership returns was ever requested, gives plaintiff's arguments in this case the distinct appearance of afterthought explanations.

On these facts, we do not find appealing plaintiff's argument that the partnerships had insufficient time in which to gather the facts essential to determine whether to elect the optional basis adjustment. In other words, we do not agree with the plaintiff that the regulations are unreasonable as applied to the facts of this case. Rather, we agree with the Government that the elections filed on August 20, 1969, were too late to be effective for the year 1967. For the partnerships to have made a valid § 754 election for the year 1967, the election should have been timely made in the original return or by an amended return filed within the statutory time for filing the original return.[17]

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[17] Cases involving elections under other sections of the Internal Revenue Code have permitted an election to be validly exercised only in an original return or in an amended return filed within the statutory time for filing the original return. *See Pacific Nat'l Co.* v. *Welch*, 304 U.S. 191 (1938); *J.E. Riley Investment Co.* v. *Comm'r*,

We now turn to plaintiff's alternative argument. Plaintiff intimates that it is entitled to use a stepped-up basis in the partnership assets for the year 1970 and all subsequent years because the elections filed on August 20, 1969, were effective as to partnership year 1970 and years thereafter. We also find no merit in this contention.

Section 754 provides that a valid § 754 election shall apply to all distributions of partnership property and to all transfers of partnership interests during the taxable year with respect to which the election was filed and all subsequent years. As applied to the instant case, the written statements filed by the partnerships on August 20, 1969, if valid § 754 elections, would apply for the year 1970 and all years thereafter, unless properly revoked. However, a valid § 754 election for the taxable year 1970 does not permit any adjustments to basis resulting from a 1967 transfer of partnership interests occasioned by the death of the decedent partner. As a result, plaintiff is not entitled to use a stepped-up basis in the partnership assets.

CONCLUSION

For the reasons hereinbefore stated, plaintiff's motion for summary judgment is denied, defendant's cross motion for summary judgment is granted and plaintiff's petition is dismissed.

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553 F.2d 658

THE SCHIAVONE-CHASE CORPORATION and THE SCHIAVONE-CHASE CORPORATION, LEHMANN DISTRIBUTORS, WHITING & PIKE, LTD., PTR (A JOINT VENTURE) v. THE UNITED STATES

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311 U.S. 55 (1940); *Haggar Co.* v. *Helvering*, 308 U.S. 389 (1940); and *Scaife Co.* v. *Comm'r*, 314 U.S. 459 (1941).

Syllabus

[No. 100–72. Decided April 20, 1977. Plaintiff's motion for rehearing denied June 24, 1977]

ON THE PROOFS

Contracts; breach; obligations under contract; tax-free importation clearance; estimated quantities; best evidence.—Plaintiffs seek damages for alleged breach by defendant of three contracts for purchase and removal of scrap materials generated by the United States Army in Vietnam. Plaintiffs allege that defendant failed to secure an expeditious clearance through Vietnamese customs for certain equipment plaintiffs imported into Vietnam and for certain equipment purchased locally from defendant all of which was needed for contract performance; and that defendant refused to permit plaintiffs to remove some of the scrap allegedly covered by one of the contracts. Defendant counterclaimed seeking payment for certain supplies furnished plaintiffs in connection with the contracts. Each contract provided that the purchaser would be granted temporary permission to import equipment into Vietnam on a tax-free basis to perform the contract. It is *held* (1) that, with respect to the equipment plaintiffs brought into Vietnam for the first time, defendant breached the contracts by failing expeditiously to perform its promise to secure tax-free importation of the equipment, so that the portion of plaintiffs' delay in using that equipment not directly attributable to deficiencies of plaintiffs' importation application is defendant's responsibility; (2) that, with respect to the equipment already situated in Vietnam that plaintiffs there purchased from defendant, defendant breached the contracts, having assured plaintiffs of tax-free import privileges that did not materialize; (3) that plaintiffs failed to sustain their burden of establishing their entitlement to take delivery of additional quantities of scrap; (4) that defendant is entitled to recover on its counterclaims; (5) that the clause providing for interest on invoices unpaid within 30 days is properly invoked; and (6) that, while plaintiffs are entitled to breach damages, they are not entitled to further damages arising from their own choice to postpone imports of additional equipment. The case is remanded to the trial division for determination of the amount of damages which, when computed, may be offset against the amount already found due defendant on its counterclaims.

Contracts; interpretation; ambiguity; generally.

[1] The rule is that if the language of contract specifications is ambiguous and the contractor's interpretation is reasonable, the ambiguity will be construed against the Government as the author of the document.

United States ⚖70(3)

Syllabus

Contracts; breach; obligation under contract; Government delay in securing customs clearances.

[2] In view of the indeterminable nature of relevant Vietnamese customs law concerning the tax-free importation of equipment needed to perform United States Government contracts, the court assumes, *arguendo*, that plaintiffs had substantive import privileges under Vietnamese law. Defendant's failure to perform its promise of securing for plaintiffs the tax-free importation of the equipment must be assumed, therefore, to have resulted from defendant's inability to resolve procedural difficulties, which constitutes breach of contract and entitles plaintiffs to recover the cost of those delays in using the equipment that was defendant's responsibility.

United States ⚖74(10)

Contracts; words and phrases; "import."

[3] The word "import" has varying meanings, depending upon its use and context. "Import" as used in the subject contracts, providing for tax-free importation of equipment for use in performing the contracts, includes not only equipment introduced into Vietnam from other territory, but also equipment, already physically located in Vietnam under an applicable tax exemption, when transferred to another tax-exempt owner. Therefore, defendant's failure to secure plaintiffs' tax-free "importation" of the equipment it sold plaintiffs constitutes a separate breach.

United States ⚖73(22)

Contracts; breach; estimated quantities contract v. term contract.

[4] Although it was originally agreed that plaintiffs were entitled to purchase and remove all scrap generated over a 2-year period, this agreement was superseded by the subsequent written contract permitting early termination upon notice and the estimates of quantities accompanying the contract. Accordingly, since at the time defendant early-terminated the contract it had already delivered to plaintiffs quantities of scrap exceeding the estimated amounts for the entire 2-year period, defendant did not breach the contract when it declined to permit plaintiffs to purchase and remove additional quantities of scrap on hand when the contract was terminated.

United States ⚖72(2), 73(22)

Evidence; weight and sufficiency of evidence.

[5] Absent plaintiffs' presentation of any conflicting evidence, defendant's only evidence in support of its counterclaims for plaintiffs' payment for certain materials supplied on a reimbursable basis, its computer billing lists, constitute the best evidence now available, even though the original signed invoices upon which the computer bills were based have now been destroyed, pursuant to regular Army policy.

United States ⚖74(11)

Monroe E. Freeman, for plaintiffs. *F. Trowbridge vom Baur*, attorney of record. *vom Baur, Coburn, Simmons & Turtle*, of counsel.

Bernard M. Brodsky, with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Before SKELTON, NICHOLS and BENNETT, *Judges.*

NICHOLS, *Judge,* delivered the opinion of the court:

This case concerning a series of contracts for the reclamation of scrap metal in Vietnam comes before the court on plaintiffs' exceptions to the findings and the decision of the trial judge.* Plaintiffs allege two breaches of contract by the Government, first, the Government's failure to secure expeditiously the clearance through Vietnamese customs for certain heavy equipment plaintiffs imported into Vietnam and for certain equipment purchased from the Government, all to be devoted to performance of the contracts; and second, the Government's refusal to permit plaintiffs to remove some of the scrap allegedly covered by one of the contracts. In addition to its defenses to these allegations, the Government asserted before the trial judge three counterclaims seeking reimbursement of the cost of certain lubricants and other supplies furnished plaintiffs in connection with the contracts. The trial judge held for the Government on all counts, including the counterclaims. For the reasons we shall explain, we disagree with the trial judge's conclusions on plaintiffs' first breach theory, although we adopt the trial judge's conclusions on the second theory and the counterclaims. Inasmuch as we hold that the Government did breach the contract, we remand for the trial judge's determination of damages, which when computed may be offset against the amount already found due the Government on its counterclaims.

Plaintiffs are three corporations which separately and in combination contracted to reclaim scrap metals in Vietnam in 1968–70. During 1968 and 1969, plaintiffs as joint venturers entered into two contracts to purchase and to remove the scrap generated by the United States Army at

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* The court acknowledges the able assistance rendered by Senior Trial Judge Mastin G. White in his recommended opinion and findings in this case. We reach a different result from his, on some issues.

its bases at Da Nang and Cam Ranh Bay; earlier, one of the corporate joint venturers had entered into a similar contract separately, covering scrap generated at Chu Lai. Each contract contained a clause stating:

> * * * IMPORTATION OF EQUIPMENT. The Purchaser will be granted temporary permission to import equipment into Vietnam on a tax free basis to perform on this contract. * * *

Plaintiffs agreed to remove the equipment from Vietnam on completing the contract, or otherwise to conform to requirements of the law.

The trial judge understood this to mean, in essence, that the Government would obtain or already had obtained the right to import "tax" free under Vietnamese law, as a matter of substance, but that the contractors had to conform to all paperwork and other procedural requirements the Vietnamese authorities might reasonably require. Plaintiffs seem to construe it as a commitment to facilitate importations by effecting the necessary paperwork, in addition to obtaining the abstract right. As will appear, defendant did in fact assume the burden of facilitation in procedural matters to a large extent, leaving plaintiffs to carry the papers from desk to desk, which belatedly they did. Thus the practical construction of the contract, during performance, was largely agreed on both sides.

Vietnam was a third world country that, before the recent war, would have needed only an unsophisticated customs service. Anyone proposing to obtain duty-free temporary import privileges would have anticipated procedural difficulties that might have made a substantive right of little value. Even in this country, with its long tradition of law-abiding and sophisticated customs practice, and with a statute or published regulation for every contingency, procedures may and often in the past have stifled substantive rights. The General Agreement on Tariffs and Trade (GATT, TD 51802) in its procedural clauses constituted a recognition that this was universally true and required worldwide attention to the discovery of remedies. The Customs Cooperation Council, that sits in Brussels, exists in large part to further the same ends.

We do not think any contractor would have accepted the IMPORTATION OF EQUIPMENT clause as adequate, if it meant only that substantively, he enjoyed temporary duty-free rights, subject to such procedural obstacles as the Vietnamese customs might devise. He would have accepted it only if he supposed that he could count on the United States Embassy, or other United States officials, to operate effectively to remove any such obstacles he might encounter in course of conforming to the usual paper routine. His obligation would be to furnish complete and truthful information to identify the equipment to be imported, and to safeguard it after importation to be sure it did not pass into the Vietnamese economy without payment of required duties. If he played his part, and obstacles still seemed insuperable, he would expect defendant to use the influence that, from the attendant circumstances of the war, he might suppose it to have. If the obstacles remained in place, it would be *res ipsa loquitur*, in his eyes, that defendant was not performing its promise. If defendant intended less, it should, in writing the contract, have spelled out the limitations on its commitment in greater detail. In view of the conflicting understanding of the provision manifestly it is ambiguous in its context, and defendant's interpretation must yield under the doctrine of *contra proferentem*. It is to be presumed that defendant hoped that scrap bidders would not make deductions from their bids to hedge against the possibility that they would have trouble importing equipment. Defendant knew the Vietnamese customs service; plaintiffs did not.

Plaintiffs contend that the Government breached this promise twice, once with respect to a crane and pickup truck that plaintiffs shipped from Manila, and later with respect to several items purchased by plaintiffs from the Government in Vietnam, the so-called "IFB equipment." We shall address each separately, as the trial judge did.

The Crane and the Pickup Truck

Plaintiffs first attempted to import a crane and pickup truck, which landed at Da Nang on May 7, 1969. Vietnamese customs officials immediately impounded the

shipment and refused to clear it for want of an application for importation complete with the serial numbers identifying each piece of machinery. Over the next 2 weeks, plaintiffs secured the United States Embassy's approval of their importation request, even though plaintiffs' documents still lacked the serial numbers demanded by the customs bureau and described the crane with an incorrect model number. In any event, it appears that plaintiffs submitted their application by the end of May. The trial judge observed that customs clearance generally awaited "2 weeks to 2 months" from the time that properly prepared documents were presented to Vietnamese customs officials. Even so, plaintiffs waited for permission to import this equipment without "tax" until November 11, 1969. Plaintiffs contend that their difficulties in obtaining import privileges for this equipment needed to compress the bulky scrap for transportation to the dock constitutes the Government's breach of the warranty of tax-free importation contained in the importation clause.

From the testimony of record, it appears that the United States Embassy officials in Saigon believed that Vietnamese customs law waived duties on equipment imported by Government contractors when necessary for the performance of their contracts. The Embassy developed procedures to assist such contractors in registering for Government contractor status, which the Embassy would certify to Vietnamese officials on the contractor's behalf once the contracts were executed. Later, when the contractors prepared to receive a specific shipment, the Embassy would further certify that the goods at dockside were, in fact, necessary for contract performance. The Embassy apparently contemplated that a shipment of Embassy-approved goods consigned to an Embassy-certified contractor would be, automatically, admitted into the country tax-free. One Government witness described the arrangement as one in which Vietnamese customs officials sought to manage the great volume of contractor requests submitted from United States contractors during this time by delegating to the United States Embassy its authority to screen its contractors' eligibility for tax exemptions.

This was not the view of plaintiffs' Vietnamese counsel, however. Citing the Vietnamese language letters of transmittal that accompanied United States Embassy contractor certifications through the Vietnamese foreign affairs ministry to the customs bureau, counsel expressed her understanding that the customs bureau retained discretion to approve or deny contractor applications for importation, regardless of the Embassy's position in the matter. Furthermore, counsel expressed her doubt that scrap metal purchasers such as plaintiffs would be regarded as qualified for importation privileges, which were extended only to contractors engaged in military or economic aid projects.

If we could determine that plaintiffs had no substantive import privileges under Vietnamese law, it would then follow directly that the Government extended in the importation clause a promise that it did not keep because it could not. This alone would establish the Government's breach. But because of the peculiar setting of this controversy, we are unable to determine what was the relevant customs law in wartime Vietnam. Upon consideration of both oral argument and the written record, we conclude, frankly, that the state of the law may now be indeterminable, for it existed less in statute or case law as in imprecise regulations, unspoken diplomatic protocols and unreported views of Vietnamese officials. Impeded as we are in finding the law, as a matter of law, we can proceed upon the assumption, as a matter of fact, that plaintiffs' substantive rights did exist. As shown above, defendant would no less have failed to deliver upon its promise of tax-free importation, if substantive rights were provided but if the contractor was effectively denied the exercise of its rights. This was the situation as we see it.

It is fair to assume that Embassy officials believed themselves able to exert great influence upon the Vietnamese, and to extract bureaucratic concessions where deemed necessary. Perhaps their confidence surpassed their abilities to achieve results. Or, perhaps placed in the larger context of events then occuring in Vietanm, the tax-free importation of scrap-reclaiming machinery did not seem to

warrant a high priority. Whatever the reason, the Government failed to perform its promise, which constitutes its breach.

The Government's contention, in response, that plaintiffs' difficulties in importing its equipment were originally of their own making is, even if true, inadequate. The trial judge found that plaintiffs' clearance documents were incomplete at the time the equipment landed at Da Nang, although he seemed to imply that they were complete by the end of May. Customs officials, nevertheless, withheld their clearance for 6 months longer, until November. The Government does not attempt any explanation for the remainder of the delay. Nor does the trial judge expand upon his finding that at least a part of the overall delay was plaintiffs' fault. While we do not quarrel directly with this finding, we maintain the view that so much of the delay not directly attributable to deficiencies of plaintiffs' importation application, was the Government's responsibility. We presume, without deciding, that this period runs from the time plaintiffs furnished sufficient applications until the time the equipment was cleared from port. The measure of plaintiffs' damages shall be the cost of this additional delay. It is appropriate now to remand for definite findings upon which to compute damages.

The IFB Equipment

Before May 1969, plaintiffs had purchased from the Government vehicles and assorted other surplus machinery already in Vietnam, called in this case "IFB equipment." The Vietnamese customs bureau rigorously restricted a contractor's use of vehicles that were admitted tax-free to Vietnam to operations necessary in performing its contracts. In order to control their use, Vietnamese customs designated these vehicles with specially coded license plates, without which they could not be used on the public roadways except to be exported from the country. In May, United States Embassy personnel assisted plaintiffs in obtaining the special plates on a temporary basis until early October when customs officials refused to extend further interim permission. According to the trial judge,

Vietnamese customs officials expected that plaintiffs would use their IFB equipment only until they could obtain substitute equipment from outside Vietnam and the authorization to use that equipment permanently. After October, customs officials did not respond to plaintiffs' further requests concerning the vehicles or other items in the IFB category, or to Embassy requests on plaintiffs' behalf. Plaintiffs enjoyed no further use of this equipment in Vietnam. Eventually, they exported their IFB equipment and borrowed Government equipment as it was available intermittently, as a partial substitute for use in scrap reclamation.

Here, as they did on their first count, plaintiffs assert their frustrated efforts to press the equipment into service as the Government's breach of the importation clause. Again we agree, and our confidence in this conclusion is enlarged as we notice that the Government's defense rests completely on a rather extreme position. The Government's sole argument is that the term "importation" in this contract's lexicon pertains only to items brought by the contractor into geographical Vietnam from outside its political borders. Thus, as the Government persuaded the trial judge, the clause would not govern the IFB equipment which was already located within Vietnam and purchased there. The trial judge goes so far as to admit that plaintiffs could have invoked the clause by shipping their IFB equipment from Vietnam to the Philippines, for example, and then returning it to Vietnam under the duty-free privilege extended Government contractors. We think this goes too far. We cannot conceive that such a wasteful endeavor might have been the intent either of a contractor, who would bear the expense, or of the Government, eager to relieve itself of a seemingly infinite glut of scrap. The more tangible flaw in the Government's analysis flows from its efforts to attach to "import" a geographical meaning.

The word "import" is, of course, somewhat of a term of art in tariff law. In general, it means what the Government says it means and therefore, does not apply to a shift in customs status of merchandise previously brought within a nation's territorial boundaries. Thus, we say, "imported or

withdrawn from warehouse for consumption," in the disjunctive. It was imported; it was warehoused; it was withdrawn from warehouse, but it was not imported on the latter occasion even though it was then that the import duties were paid. But it can have a variable meaning dependent on context. Thus in *Procter & Gamble Mfg. Co.* v. *United States*, 19 C.C.P.A. (Customs) 415, *cert. denied*, 287 U.S. 629 (1932), merchandise produced on the high seas, whale oil, was held imported, because the context of the act assessing duties on fishery products required that construction, though the statutory definition would have required it to be brought from a foreign country. We think the context likewise requires here that the word "import" should include purchase within Vietnam of imported goods from another temporary importer. In *Procter & Gamble*, *supra*, at 422, the court said:

> It is quite often found necessary, in construing provisions in tariff acts to conclude that a certain term has varying meanings, according to its uses and context. An example is the word "import." This term may mean to bring goods within the jurisdictional limits of the country. [Citing cases]; or it may mean the time when it is withdrawn from warehouse and enters the commerce of the country. [Citing cases.]

It may be noted that the IMPORTATION OF EQUIPMENT clause was, obviously, inartfully drafted by one not familiar with tariff terminology. It refers to importing "on a tax-free basis." Properly, exactions incident to the importation of merchandise are called "duties," not taxes. Defendant might well argue that Vietnamese customs duties were not "taxes" and so not within the warranty. Such an argument would be quite in line with the one actually made concerning the meaning of the word "import."

By controlling imports and exports of tangible goods, along with currencies, the Vietnamese government sought to insulate its domestic economy, as best it could, from intolerable inflation and rampant black marketeering. Exemption from economic regulation was provided where deemed necessary to further the military campaign, however, for such activities were considered apart from the

Vietnamese local economy. Similarly, purchases of United States Government-owned property were regarded as separate, and were relatively unregulated like other non-Vietnamese commerce. Meanwhile, the indigenous Vietnamese economy was thoroughly regulated by a complex system of controls. Thus, a two-tiered economy was permitted to develop. The customs law was one mechanism, in our understanding, that kept the two tiers apart.

The law was comparatively unconcerned with transactions that were not within the domestic economy, purchases or sales between foreign nationals paid for in foreign currency, for example. These might be considered "imports" in one sense, if the merchandise entered the country from another. But that was not the distinction operable in Vietnamese law. Rather, an import was a transaction that caused merchandise to enter the Vietnamese economy, regardless of when it entered the country. Thus, a customs "tax" was due upon goods when entering the Vietnamese economy, even though the goods themselves might have been in Vietnam for some time, may have moved physically only between two Vietnamese towns, or across town. Regardless of geography, the duty would be imposed unless the parties to the transaction could establish that their business, contrary to first appearances, was still outside the local economy. These exceptional transactions, temporarily excused from taxes otherwise imposed, were the "tax-free imports" to which the importation clause applied.

A particular purchaser's ability to qualify for "tax" exemption appears to have depended on his own identity and his purpose for doing business in Vietnam. The question involves the same substantive issues that we found ourselves unable to resolve in connection with plaintiffs' crane and pickup truck. Suffice it to say, though, that we find the Government in the same position here with respect to the IFB equipment, having assured plaintiffs of tax-free import privileges that did not materialize. We sustain plaintiffs' allegation of the Government's breach of contract.

Once again, a word regarding damages might be of useful guidance to the trial judge on remand. Plaintiffs should

recover on this count the losses and expenses they incurred from their inability to use the IFB equipment in furtherance of the contract. Plaintiffs, however, seek further damages, related to their decision in May and June 1969 not to import from the United States certain other items of heavy equipment. The trial judge determined that plaintiffs based their decision on their difficulties with the IFB equipment. We think the situations were different, and one should not have influenced a decision on the other. Difficulties surrounding the importation of IFB equipment were not the same that plagued the importation of the crane and pickup truck, which was a situation more akin to that involved in bringing equipment from the United States. By July 1969, moreover, plaintiffs anticipated no further delays in such imports from other countries. Therefore, we conclude that plaintiffs are not entitled to compensation arising from their own choice to postpone imports of additional equipment.

The Chu Lai Contract

This claim, based on the allegation that plaintiffs were entitled to remove larger quantities of scrap from Chu Lai than the Government delivered, involves only one of the contracts undertaken by the joint venture. The contract was negotiated for plaintiffs by one of the joint venturers, The Schiavone-Chase Corporation (SCC).

On November 7, 1968, SCC wrote to the contracting officer to express its interest in salvaging and removing from Vietnam "all scrap and salvageable material located in Chulai at the present time including the generation for the next two years with the option of one more year." On December 17, the contracting officer informed plaintiff that its offer for a two-year term contract for the property located in the Chu Lai area had been accepted. The contracting officer further advised that "minor details * * * will be worked out by the time the contract is prepared." Thereafter, SCC received a formal proposal containing provisions for the negotiated sale of scrap at Chu Lai. The proposal included estimated quantities of various categories of scrap that the Government would sell

and the plaintiff agreed to buy. These estimates, determined after plaintiff's and defendant's representatives toured the scene at Chu Lai, were acceptable to both parties. On January 28, 1969, SCC and defendant executed the standard form contract entitled "Sale of Government Property, Bid and Award," to which the contracting officer attached a separate form incorporating, with few revisions, the estimated quantities previously agreed upon as the amount of scrap to be covered by the contract. The purpose of this formal advice was to notify the contractor that it had been awarded the contract, and to furnish a description of the subject matter of the award.

The contract also contained the following provisions:

> *ARTICLE AM—TERMINATION.* This contract will cover the period shown in the item description both dates inclusive unless sooner completed, or terminated by either party upon thirty days' written notice to the other, to be calculated from the date the notice is mailed.
>
> * * * * *
>
> ARTICLE AO—ADJUSTMENT FOR VARIATION IN QUANTITY OR WEIGHT. * * * When property is sold on a "unit price" basis, the Government reserves the right to vary the quantity or weight delivered by 50% from the quantity or weight listed in the Invitation; and the Purchaser agrees to accept delivery of any quantity or weight within these limits. The Purchase price will be adjusted upwards or downwards in accordance with the unit price and on the basis of the quantity or weight actually delivered.

Plaintiffs promptly began to prepare a base and hire personnel at Chu Lai, but large-scale processing and shipment of material out of Chu Lai could not begin because the port there was closed by Vietnamese authorities until July 1, 1969. Plaintiffs began full-scale operations under the contract on July 15. Operations were continued there until May 21, 1970, when defendant terminated the Chu Lai contract by a formal notice dated April 20, 1970.

By the time the Chu Lai contract was terminated, defendant had delivered to plaintiffs quantities of scrap that exceeded the estimated amount in each major category. At trial, plaintiffs' witnesses testified that there was, nevertheless, additional scrap at Chu Lai at that time,

which the Government refused to deliver. Plaintiffs now contend that they were entitled to buy these quantities under the Chu Lai contract, even though in every category the quantity of scrap then on hand, when added to quantities previously delivered, would have exceeded the estimated quantities originally agreed upon. Plaintiffs base their contention upon the general agreement that was reached in the exchange of correspondence dated November 7 and December 17, 1968, that SCC would purchase all scrap then located in Chu Lai plus the scrap generated there in the next 2 years. Plaintiffs deny that this general agreement was affected either by the joint estimates of quantities that accompanied the written contract, or by the contract term that reserved to the Government the right to vary quantities.

The trial judge reasoned correctly, in rejecting plaintiffs' arguments, that the contract and the estimates superseded the general agreement represented by the original correspondence. Accordingly, defendant did not breach the Chu Lai contract by declining to permit plaintiffs to purchase and remove the quantities of scrap that may have been on hand when the contract was terminated.

The trial judge further found that there was a substantial conflict in the evidence presented by the parties concerning the amounts of different types of scrap that actually were on hand at Chu Lai in May 1970. When such conflicts are carefully evaluated, it must be concluded that plaintiffs have failed to sustain their burden to establish that they were entitled to take delivery of additional quantities of scrap.

The Counterclaims

Defendant's three counterclaims concern petroleum products and industrial gases that defendant allegedly supplied plaintiffs on a reimbursable basis, but for which plaintiffs failed to pay. Defendant substantiates its counterclaims with computer billing lists contained in its own books and records, and with a defense witness' testimony that these computer billing lists were prepared from original "hard copy" documents that were signed by

plaintiffs' authorized representative each time supply items were furnished to the joint venture.

When plaintiffs sought to audit defendant's books and records in connection with these counterclaims, they discovered that most of the original supporting documents had been destroyed, pursuant to the Army's policy in Vietnam of discarding such papers after 2 years. Inasmuch as most of the computer lists are not supported by any original documentation now in existence, plaintiffs contend that the counterclaims should be dismissed for lack of proof.

In view of the circumstance that the computer lists constitute the best evidence that is available now, however, as well as the fact that plaintiffs did not present any conflicting evidence, it was the trial judge's opinion that the interests of justice would be served by accepting the computer lists as establishing the validity of defendant's counterclaims. Since we agree, defendant is entitled to a judgment against plaintiffs in the amount of $231,331.83, together with interest at the rate of 6 percent per annum from the respective dates of the several billings to the time of payment.

In connection with the interest issue, Article L of each contract provided that, unless paid within 30 days from the date of first written demand, all amounts due the Government from plaintiffs would accrue interest at 6 percent per annum from the date of first demand until paid. Each contract, as modified, contained a provision for the Government's furnishing plaintiffs logistical support on a reimbursable basis, such as the supplies subject of the counterclaims. Thus, the interest clause is properly invoked.

After due consideration, we conclude that plaintiffs' exceptions to the trial judge's findings, do not warrant that those findings be disturbed. Therefore, the court adopts those findings as its own, making them available to the parties although they are not reprinted.

CONCLUSION OF LAW

Accordingly, the court determines that plaintiffs are entitled to recover on their principal claims to the extent

Syllabus

indicated in the opinion. Defendant is entitled to recover on its counterclaims. The case is remanded to the Trial Division for further proceedings consistent with this opinion and Rule 131(c), to determine the net amount owing to plaintiffs or defendant, to be awarded in the final judgment of the court.

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553 F.2d 651

SEA-LAND SERVICE, INC. v. THE UNITED STATES

[No. 331–72. Decided April 20, 1977. Plaintiff's suggestion for rehearing *en banc* and motion for rehearing to alter judgment denied June 24, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; disputes; fuel cost increase; absence of escalation clause.—In June 1970 plaintiff entered into a one-year, fixed-price contract to transport by water containerized cargo between the United States and foreign ports. In January 1971 plaintiff sought a temporary bunker fuel surcharge based on a worldwide drastic increase in rates of such fuel, contending that the increase constituted a compensable contract change and that it was the custom of the trade to impose bunker fuel surcharges. Defendant denied plaintiff's attempt, pursuant to Art. I:9(b), to nominate "as a change to or additional item of cost responsibility, to be incorporated into Appendix B, a bunker surcharge" on the ground that it was inconsistent with Arts. I:5, I:6 and I:8 of the contract. The contract appeals board held that the contract contained no authorization for price escalation to cover such cost increases. Plaintiff seeks review of the board's decision under Wunderlich Act standards, asserting entitlement to recover $2.00 per ton on 4,077,009 tons of transported cargo. It is *held* that the board correctly interpreted the contract, that its decision was not arbitrary, capricious and was supported by substantial evidence, that the contract is not ambiguous, that the contract placed the risk of increase in bunker fuel costs on plaintiff, and that there is no evidence as to the custom of the trade, except that relating to custom in 1972 and thereafter, after expiration of the subject contract. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Contracts; interpretation; reimbursable costs; fuel cost increase; absence of price escalation clause.

[1] Where plaintiff contracted to transport cargo by water under a one-year, fixed-price contract whose Art. I:3 makes the specified rates the

compensation to be paid the carrier, App. B1c(13) makes costs in connection with operation of the vessel the responsibility of the carrier, Art. I:20 provides that the specified rates were to continue unchanged, and there is no provision for escalating the compensation, plaintiff is not entitled to reimbursement for additional costs occasioned by a drastic increase in price of bunker fuel since it assumed the risk of dollar increases under the terms of the contract.

United States ⚖72(1)

Contracts; interpretation; conduct of parties as aid to.

[2] Only actions and interpretations which occur before a controversy arises are relevant in determining and interpreting the meaning of a contract. Thus, where the Government modified follow-on contracts effective the same day the subject contract expired, by adding an escalation clause to cover fluctuations in costs of bunker fuel, such modification had no effect on the subject contract.

United States ⚖72(5)

Contracts; interpretation; trade usage or practice.

[3] When the terms of a contract are clear and unambiguous, there is no need to resort to the custom of the trade for its interpretation.

Customs and Usages ⚖15(1)

Paul J. McElligott, attorney of record for plaintiff. *Ragan & Mason,* of counsel.

Raymond B. Benzinger, with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Before SKELTON, NICHOLS, and BENNETT, *Judges.*

SKELTON, *Judge,* delivered the opinion of the court:

The plaintiff, Sea-Land Service, Inc. (Sea-Land) a common carrier by water within the Shipping Act, 1916, 46 U.S.C. § 801, *et seq.,* entered into Contract N0003371CA1464 with the Military Sea Transportation Service (now Military Sealift Command (MSC)), of the Department of the Navy, effective July 1, 1970, and extending one year to June 30, 1971, for the transportation of containerized cargo between the United States and various foreign ports. The contract was drafted by the United States and was filed by Sea-Land with the Federal Maritime Commission as a statement of rates, terms, and conditions of the service to be furnished by the plaintiff. The pertinent provisions of the contract were as follows:

* * * * *

ARTICLE I:1 *DESCRIPTION OF SERVICES*

The Carrier represents that he is a common carrier by water within the meaning of the Shipping Act of 1916, as amended; that he operates or will inaugurate by the date stated in the STATEMENT OF RATES an established berth service on the trade routes for which rates are quoted in the SCHEDULE OF RATES, and that he maintains on such routes regularly scheduled sailings of United States flag vessels. The Carrier further represents that he offers container service on the above designated routes to the public for the carriage of commodities having the general shipping characteristics of those for which service may be performed under this Agreement . . . . The term 'Container Service' as used in this Agreement means the movement of cargo in Carrier or Government-furnished containers and the transportation of Government containers, on regularly scheduled vessel sailings for the general public at duly published rates, terms and conditions. In carrying cargoes for the Government in containers in any of his scheduled vessels as provided in this Agreement, the Carrier shall carry as a common carrier.

ARTICLE I:2 *TERMS OF CONTRACTUAL RELATIONSHIP*

(a) The purpose of this Agreement is to establish the terms under which the Carrier offers to accomplish the transportation in containers of such lawful cargo . . . as may be tendered from time to time by the Government for carriage under the Agreement. When transportation services are ordered under this Agreement, a Shipping Order substantially in the form attached hereto as Appendix A . . . will be issued by the Government. The Government will also prepare all necessary papers including vessel papers or manifests listing the cargo stowed in containers aboard the vessel and such will be receipted for by the Carrier or his agent. Such papers, including vessel papers or manifests, shall be evidence of ownership and together with the Shipping Order constitute the contract of carriage, and all the terms of this Agreement shall be deemed as incorporated therein as part thereof . . . .

* * * * *

(e) Nothing in this Agreement shall be construed as restricting competition in any manner or as precluding the Government from obtaining transportation from the Carrier on the routes covered herein under the published

tariffs of the Carrier that are available to the public, provided goods to be so carried shall be tendered in accordance with the terms and conditions of those tariffs and for carriage under a standard form of Government Bill of Lading . . . .

ARTICLE I:3 *COMPENSATION*

Compensation for carriage of goods under this Agreement shall be in accordance with the SCHEDULE OF RATES . . . .

* * * * *

ARTICLE I:5 *SCOPE OF SERVICE*

(a) The Carrier shall furnish the following services for which rates are published in the SCHEDULE OF RATES.

(i) BASIC SERVICE: *The Carrier's basic service for which he shall be paid at the basic rates set forth in the SCHEDULE OF RATES* shall consist of furnishing a clean empty container on a trailer to the Government at his terminal; receiving and handling the stuffed container at his loading terminal; loading and *transporting the container in his vessel;* discharging and handling the container at his receiving terminal; furnishing the container on a trailer; and paying all port charges occurring against the container and its contents except charges measured by the volume, weight or value of the cargo.

(ii) DRAYAGE SERVICE: The Carrier's drayage service for which he will be paid at the drayage rates set forth in the SCHEDULE OF RATES . . . .

(iii) STOP-OFF SERVICE: The Carrier's stop-off service for which he shall be paid at the stop-off rates set forth in the SCHEDULE OF RATES . . . .

(iv) STUFFING SERVICE: The Carrier's stuffing service for which he shall be paid at the stuffing rates set forth in the SCHEDULE OF RATES . . . .

(v) TEMPERATURE RECORDING SERVICE: The Carrier's temperature recording service for which he shall be paid at the temperature recorder rate set forth in the SCHEDULE OF RATES shall consist of furnishing a continuous temperature recording instrument in each refrigerated container when so requested by the Contracting Officer at the time the container is ordered . . . .

(vi) SUPERCARGO TRANSPORTATION SERVICE: The Carrier's supercargo transportation service for

which he shall be paid at the supercargo transportation rate set forth in the SCHEDULE OF RATES . . . .

(b) Freight shall be computed for each container and shall consist of the sum of all payments due for each of the above services actually furnished in accordance with the orders of the Contracting Officer as set forth in the Shipping Order.

ARTICLE I:6 *GENERAL CONDITIONS OF SERVICE*

. . . .

[This article contained detailed provisions covering miscellaneous activities such as notice to spot, pick up, and remove containers, the use of trailers for moving containers during stuffing, avoidance of areas unsafe for tractors and trailers, delivery of containers at point of discharge, provision of information regarding each container, notice of impending arrival of the vessel, and maintenance of refrigeration for refrigerated containers.]

* * * * *

ARTICLE I:8 *PORT CHARGES*

The Carrier shall pay all port charges, canal tolls and similar charges (properly for the account of the vessel) including such charges assessed at Government installations.

ARTICLE I:9 *SCHEDULE OF COST RESPONSIBILITIES*

(a) As a means of facilitating the administration of this Agreement, the parties have agreed that certain specific items of cost anticipated as likely to arise in the performance of their respective duties under Articles I:5, I:6 and I:8 shall be listed, and the cost responsibilities of the parties indicated, in a schedule attached hereto as Appendix B . . . and made a part of this Agreement. *Determinations of responsibility for specific items of cost agreed to by the parties under this Article are to be consistent with the general language of Articles I:5, I:6 and I:8;* provided, however, in the event of conflict, the specific language of Appendix B shall prevail.

(b) *Either party may nominate changes to or additional items of cost and cost responsibility to be incorporated into Appendix B.* Such nominating party shall serve upon the other party a written nomination, *together with a detailed statement of all pertinent facts and appropriate supporting data necessary for a determination of the cost responsibility under Articles I:5, I:6 and I:8.* If the

other party agrees in writing to the nomination, such nomination will be incorporated into Appendix B as of the agreed effective date. Failure of the other party to agree to the nomination within a period of thirty (30) days from its receipt, or within a mutually agreeable greater period, shall constitute a dispute concerning a question of fact within the meaning of that term in the Article entitled 'Disputes' in Part III of this Agreement.

* * * * *

ARTICLE I:19 *SCHEDULE OF RATES*

(a) The SCHEDULE OF RATES is a part of the MSTS Container Agreement. It consists of SECTION I, STATEMENT OF BASIC RATES; SECTION II, STATEMENT OF DRAYAGE RATES; SECTION III, STATEMENT OF MISCELLANEOUS RATES; AND SECTION IV, STATEMENT OF RATES FOR CARRIAGE OF GOVERNMENT CONTAINERS.

(b) SECTION I consists of a separate Statement of Basic Rates for each route for which the parties have negotiated rates . . . .

(c) SECTION II consists of a Statement of Drayage Rates, and the rates stated therein shall apply when the Carrier is ordered to dray a container between his terminal where the container is loaded on or discharged from his ship and another place . . . .

(d) SECTION III consists of Statement of Stuffing Rates, Stop-off Rates, Demurrage Rates (Charges for Container Detention) and other Miscellaneous Rates.

(e) SECTION IV consists of a Statement of Rates for Carriage of Government-Owned or Leased Containers and the rates, terms and conditions stated therein shall apply to services furnished by the Carrier in connection with containers, other than Carrier-owned containers, which are offered by the Government for shipment.

ARTICLE I:20 *ADDITIONS AND REVISIONS*

(a) Except during the one year period for which the parties have agreed that rates stated in SECTION I, SECTION II, SECTION III, and SECTION IV shall remain effective, the SCHEDULE OF RATES may be amended by the parties in the following manner. Either party may propose in writing that all or a portion of the SCHEDULE OF RATES be amended. No later than thirty (30) days from receipt of such proposal the parties shall undertake to negotiate such an amendment and, if agreement is not reached within sixty (60) days from the commencement of such negotiations, the Carrier shall

have the option of withdrawing that portion of the SCHEDULE OF RATES which is the subject of the dispute, such withdrawal being effective after thirty (30) days notice in writing to the Government and being subject to the requirements of applicable statutes and of rules and regulations of cognizant Government agencies.

* * * * *

Appendix B to Part I, referred to in Article I:9, set forth above, contained the following pertinent matter (with emphasis added):

APPENDIX B

SPECIFIC ITEMS OF COST IN CONNECTION WITH PERFORMANCE UNDER ARTICLES I:5, I:6 AND I:8 AND AGREED DETERMINATION OF COST RESPONSIBILITY AS BETWEEN THE PARTIES

1. *Responsibility of the Carrier*

The Carrier is responsible for the cost of the following services:

a. Furnishing and maintaining containers and trailers except when trailers are waived or containers or trailers are furnished by the Government
b. Drayage (when ordered) . . . .
c. *Port charges and other expenses applicable to the Carrier's vessel:*
   (1) Pilotage
   (2) Tug hire
   (3) Line handling
   (4) Utilities and other services required by the vessel
   (5) Dues (including harbor and quay dues), fees (including light-house fees) and/or taxes assessed against the vessel
   (6) Dockage (or side wharfage), berthage, sheddage, wharfage (or top wharfage)
   (7) Agency fees
   (8) Canal transit tolls
   (9) Customs
   (10) All charges in connection with vessel entrance and clearance
   (11) Special fire or security watch required as a condition to stay in port
   (12) Terminal service and facilities charges at commercial piers

(13) *Other costs in connection with operation of the ship*

* * * * *

[Emphasis supplied.]

The contract also contained the standard disputes clause.

On January 4, 1971, Sea-Land applied to defendant for a temporary bunker fuel surcharge on rates in the contract based on "drastic increase in the cost of bunker fuel on a worldwide basis." The defendant rejected plaintiff's application on January 5, 1971, on the ground that there were no provisions in the contract that authorized a rate increase to cover increases in the cost of bunker fuel.

On January 18, 1971, plaintiff, purporting to act in accordance with Article I:9(b) of the contract, nominated "as a change or additional item of cost and cost responsibility, to be incorporated into Appendix B, a bunker surcharge to cover the bunker fuel price recently imposed by suppliers." The plaintiff also cited the "custom of the trade" to impose bunker surcharges, which had been recognized by the Federal Maritime Commission. The plaintiff justified its action by citing the drastic increases in bunker fuel and an expected further increase in early 1971. The defendant denied plaintiff's nomination on the ground that it was inconsistent with Articles I:5, I:6, and I:8 of the contract. Plaintiff appealed to the Armed Services Board of Contract Appeals (ASBCA or Board). The Board denied plaintiff's appeal on August 4, 1972.[1] The decision of the Board was as follows:

DECISION

Meaning of Contract Provisions. The dispute ultimately concerns the meaning of Article I:9(b) of the "basic terms of agreement," viewed in the context of Article I:9(a), Appendix B, and the other related provisions, such as Articles I:3, I:5(a)(i) and (b), and I:20(a).

We are unable to entertain the view advanced by appellant that Article I:9(b) provides a means for escalating freight rates to compensate for the increased cost of bunker fuel as measured by the claimed surcharge or otherwise.

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[1] ASBCA No. 16218, 72-2 BCA ¶ 9605.

Appellant's claim tacitly assumes that the cost items in Appendix B had a dollar value at the outset, and that consequently, when a higher dollar cost is actually experienced for an item present in Appendix B as a carrier responsibility, the increase can be nominated by the carrier as a "change to" or "additional item of cost" under Article I:9(b).

Such is not the case. Appendix B describes costs only by nature, kind, or character without regard to any dollar amount and without any warranty against inclusion of contingency factors in rates. Contrary to appellant's assumption, the contract in truth is cast in terms which provide that the risk of dollar increases in costs of the items of cost assigned to the carrier shall be covered by the stipulated rates. Article I:5(a)(i) makes transportation of the container, along with handling etc., the basic service for which rates are to be paid. Transportation at a given rate is, therefore, central to the principal apparent purpose of the contract; and Article I:3 makes the rates the compensation to be paid. Appendix B 1c(13) makes costs in connection with the operation of the vessel (in addition to those expressly mentioned in Appendix B 1c(1) through (12)) part of the cost responsibility of the carrier. There is no contention or evidence of the existence of any applicable usage which by implication would exclude the cost of fuel from the cost of operation of the vessel under this type of berth service contract in the absence of an express exclusion, and appellant necessarily concedes that the cost of fuel was not excluded here. Moreover, under Article I:20(a) the rates are intended to continue unchanged for a year.

Thus the entire thrust of the relevant contract provisions, particularly Article I:5(a)(i) and Appendix B 1c(13), is to place the risk of increases in bunker fuel costs (and the benefit of any decline) on the carrier. In making a nomination under Article I:9(b) a party is required to demonstrate consistency with Article I:5(a)(i). Nomination of the added dollar cost of fuel is neither the nomination of a change to an existing item nor the nomination of an additional item, is inconsistent with Article I:5(a)(i), and would frustrate the principal apparent purpose of the contract.

Conclusion. In our opinion, the contract, interpreted in accordance with the usual canons of interpretation, unambiguously excludes entitlement to recovery, under Article I:9(b) of the "basic terms of agreement," of the increased cost of bunker fuel by surcharge or otherwise. See *Restatement, Contracts (1932)*, see 230, 235, 236 (a), (b). Accordingly, the appeal is denied.

Plaintiff filed this suit on August 29, 1972, seeking review and reversal of the decision of the Board under the standards of the Wunderlich Act, 41 U.S.C. §§ 321, 322 (1970). It seeks to recover $2.00 per ton on 4,077,009 tons of transported cargo. The case was heard by a panel of the court which entered an order on May 31, 1974, 204 Ct.Cl. 912, which provided:

> * * * [T]he case is remanded to the Armed Services Board of Contract Appeals, under Public Law 92–415 and General Order No. 3 of 1972, to determine whether the drastic increase in the cost of bunker fuel, on which plaintiff predicates this claim, was foreseen by plaintiff when it entered into the contract on July 1, 1970, or was reasonably foreseeable at that time as likely to arise during the contract period;

On remand, the Board issued its opinion on April 30, 1976, holding that the drastic increase in bunker fuel prices was not foreseen by the plaintiff and, by a three to two decision held that such increase was not reasonably foreseeable. The Board did not change its opinion of August 4, 1972, *supra*.

The case is now before us on plaintiff's motion and defendant's cross-motion for summary judgment.

Plaintiff contends that the decision of the Board was arbitrary, capricious, and not supported by substantial evidence. We do not agree and conclude that the contrary was true. Plaintiff argues further that we are not bound by the decision of the Board in interpreting the contract since this is a question of law. We agree that this is a correct statement, but we conclude that the Board correctly interpreted the contract and we approve the interpretation which it made. We find no fault with the decision of the Board and conclude that its decision should be affirmed.

Plaintiff argues that the contract is ambiguous and all doubts should be resolved against the defendant who drafted the contract in accordance with the *contra proferentem* rule. We do not agree that the contract is ambiguous and, consequently, we do not apply the aforesaid rule. *See ITT Arctic Services, Inc.* v. *United States*, 207 Ct. Cl. 743, 524 F.2d 680 (1975). It should be remembered that the contract is a fixed price contract

under which the plaintiff was to furnish specified services for specified payments for a period of one year. There was no provision for escalating the amounts that would be paid to the plaintiff. The plaintiff would engraft an escalation clause on the fixed price contract, which cannot be done in the circumstances of this case. It is unfortunate that the plaintiff got caught by the increase in price of the bunker fuel, but that was a risk it assumed under the terms of the contract. As the Board pointed out, Article I:3 makes the rates the compensation to be paid and Appendix B1c(13) makes costs in connection with the operation of the vessel, which certainly includes bunker fuel, the responsibility of the carrier. Furthermore, under Article I:20 the specified rates were to continue unchanged for the period of one year.

Plaintiff relies on its right to nominate "changes to or additional items of cost and cost responsibility to be incorporated into Appendix B." This article does not mean that plaintiff by simply nominating bunker fuel cost increases, binds the government by such nomination and that this amounts to an escalation clause that increases the rates. Article I:9(b) states that any nomination must comply with Articles I:5, I:6 and I:8. Article I:5 states that the carrier "shall be paid at the basic rates set forth in the schedule of rates." Plaintiff's nomination does not comply with this article. Article I:6 deals only with general conditions of service and is not particularly relevant here. Article I:8 requires the carrier to pay all port charges.

We agree with the Board that Article I:9(b) does not provide a means for escalating freight rates to compensate for increased cost of bunker fuel. That article states that "either party may nominate changes to or additional items of cost and cost responsibility to be incorporated into Appendix B." As the Board held, the cost items in Appendix B had a dollar value, and when that dollar value increased as to any item that was a carrier responsibility, such increase cannot be nominated by the carrier as a "change to" or "additional item" of cost under Article I:9(b). The Board correctly stated that "Appendix B describes costs only by nature, kind, or character without regard to any dollar amount and without any warranty

against inclusion of contingency factors in rates. Contrary to appellant's assumption, the contract in truth is cast in terms which provide that the risk of dollar increases in costs of the items of cost assigned to the carrier shall be covered by the stipulated rates. Article I:5(a)(i) makes transportation of the container * * * the basic service for which rates are to be paid. * * * Article I:3 makes the rates the compensation to be paid. Appendix B1c(13) makes costs in connection with the operation of the vessel [which includes bunker fuel costs] part of the cost responsibility of the carrier."

We conclude that the contract placed the risk of increases in bunker fuel costs on the plaintiff. When Sea-Land made the nomination under Article I:9(b) it failed to show it was consistent with Article I:5(a)(i). The nomination of the increased cost of fuel was neither the nomination of a *change to an existing item* nor the nomination of *an additional item* and was inconsistent with Article I:5(a)(i). Actually, plaintiff's nomination as to increased fuel costs was an effort on its part to force the defendant to pay a part of the costs of the operation of the vessel, which was clearly its obligation under the contract.

Plaintiff argues further that the defendant should be required to pay the increased fuel costs because during plaintiff's appeal the government modified follow-on contracts by adding, effective July 1, 1971, an escalation clause to cover fluctuations in costs of bunker fuel. Such change did not affect the contract in issue here, because it terminated on July 1, 1971, which was the date the change became effective. It is well settled that only actions and interpretations which occur before a controversy arises are relevant in determining and interpreting the meaning of a contract. *See Liles Constr. Co.* v. *United States*, 197 Ct. Cl. 164, 455 F.2d 527 (1972); and *Dynamics Corp. of America* v. *United States*, 182 Ct. Cl. 62, 389 F.2d 424 (1968).

Plaintiff says that Article I:9 is ambiguous and should be construed against the government. We conclude that it is unambiguous and there is no requirement that it be construed against the government. *See ITT Arctic Services, Inc.* v. *United States, supra.*

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Plaintiff argues further that the "custom of the trade" should have been considered in interpreting the contract. It is well settled that when the terms of a contract are clear and unambiguous, there is no need to resort to the custom of the trade for its interpretation. Furthermore, there was no evidence as to the custom of the trade, except that relating to custom in 1972, and thereafter, after plaintiff's contract had expired and escalation provisions had been inserted in follow-on contracts.

We hold that the Board properly construed the contract provisions and that its decision was not arbitrary nor capricious and was supported by substantial evidence and is entitled to finality and it is hereby affirmed.

Accordingly, plaintiff's motion for summary judgment is denied, the cross-motion for summary judgment of defendant is granted, and plaintiff's petition is dismissed.

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554 F.2d 435

DISCOUNT CO., INC. v. THE UNITED STATES

[No. 178–75. Decided April 20, 1977. Plaintiff's motion for rehearing denied May 27, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; disputes; default termination; failure to make progress.—In May 1968 the Forest Service awarded plaintiff a contract to construct a boat launching ramp, parking lot and campgrounds in Willamette National Forest, Oregon, the work to be completed within 180 days of the notice to proceed issued June 24, 1968. When work was suspended in December 1968 because of adverse weather conditions, plaintiff was on schedule. However, plaintiff complained that the designated borrow site contained so much unsuitable material that it represented a changed condition; a dispute also arose as to the nonconforming construction of the parking area and boat ramp. In June and July 1969, respectively, the Government issued partial and full resumption of work orders, the latter taking into account the Government's anticipated "as is" acceptance of the boat ramp. However, since no substantial amount of work was performed on the campgrounds, defendant sent a 10-day cure notice demanding resumption of work and requesting a work schedule. Plaintiff neither resumed work nor provided the schedule, and on August 12, 1969 the contract was default terminated. In June 1969

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the Government had submitted to plaintiff a pay invoice representing an estimated progress payment for work done in 1968, plaintiff disputed the estimated percentage of work completed and refused to sign, and, when an agreement was reached as to the amount due, plaintiff was in default of the cure notice and payment was withheld to protect the sureties. On appeal, the contract appeals board found that plaintiff failed to perform sufficient work during 1969, that its failure was unexcused, that termination was warranted, and that there was no evidence before it sufficient to prove that failure to proceed was connected with plaintiff's non-receipt of progress payments. It is *held* that the board's determination is supported by substantial evidence on the record before the court and is in harmony with relevant contract law. Defendant's motion for summary judgment is granted, plaintiff's motion is denied, and the petition is dismissed.

Contracts; performance; duty of contractor to continue performance.

[1] Although plaintiff had filed a claim for an equitable adjustment to cover costs of removing allegedly unsuitable material from the initially designated borrow site, since the material was not so unsuitable as to make performance impossible, plaintiff had a duty to continue performance during processing of its claim.

United States ⚖73(17)

Contracts; disputes; administrative remedies; change order; duty of contractor to continue performance.

[2] Where a change order designated an alternate borrow site, but the contractor, although not objecting to the new site, rejected the change order because it did not include an upward equitable adjustment for higher transportation costs, it was plaintiff's contractual obligation to continue performance under the change order since it could have protected its right to an equitable adjustment by proceeding under the contract's disputes clause, regardless of whether the designation of the new site was merely a Government proposal or a fully operative and effective change order.

United States ⚖73(17)

Contracts; termination; default termination; anticipated failure to complete.

[3] Where a demonstrated lack of diligence of the contractor to proceed with its work under the contract indicated that the Government could not be assured of timely completion, default termination for failure to make progress was justified.

United States ⚖72(7)

Contracts; delays; excusable delay.

[4] Financial difficulties create excusable delays only if precipitated by Government actions.

United States ⚖73(26)

Presumptions; official actions of Government officials; presumption of regularity.

[5] The presumption of official good faith can be overcome only by well-nigh irrefragable proof.

United States ⚖74(10)

Ralf H. Erlandson, attorney of record, for plaintiff.

Robert M. Hollis, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, KASHIWA and KUNZIG, *Judges*

DAVIS, *Judge*, delivered the opinion of the court:

This contract case is before us under the Wunderlich Act, 41 U.S.C. §§ 321–22 (1970), for scrutiny of a decision by the Department of Agriculture Board of Contract Appeals (Board). Plaintiff, Discount Company, Inc., appealed its termination for default to the Board, requesting that the termination be considered for the convenience of the Government.[1] The Board decided that the default termination was appropriate and Discount subsequently requested a rehearing, which was denied with an opinion. Plaintiff then brought suit here to review the Board's decision, and Trial Judge Browne has recommended that the administrative determination in favor of the Government be reversed. We conclude, however, that the Board's upholding of the default termination should stand.

In May, 1968, the Forest Service awarded plaintiff a contract to construct the Mona Campground and Lookout Boating Site in the Willamette National Forest, Oregon. For a contract price of $104,399.99, Discount was to complete a boat launching ramp, parking lot and campgrounds within 180 days of the notice to proceed, which was issued on June 24, 1968.

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[1] A termination for convenience is generally more favorable to a contractor than one for default. Under a termination for convenience, a contractor may receive his costs and any profit to date. If terminated for default, the contractor loses compensation for unpaid work-in-progress, and may be liable for delay or liquidated damages and excess costs of reprocurement. *See, e.g., G.L. Christian and Assoc. v. United States*, 160 Ct. Cl. 1, 312 F.2d 418, *cert. denied*, 375 U.S. 954 (1963); R. NASH & J. CIBINIC, FEDERAL PROCUREMENT LAW, pp. 651–90, 755–778, 2d ed. (1969).

From the beginning, plaintiff encountered difficulties on the job.[2] Discount was nonetheless on schedule at the time work was suspended (due to adverse weather conditions) in December, 1968. In October, 1968, the contracting officer had decided that plaintiff's work on the parking area and boat ramp was not in accordance with specifications and directed the contractor to remove the structures during the next construction season.[3] In addition, the contracting officer reminded plaintiff that during the next construction season the boat ramp area would be partially covered by the rising water level in the Lake Mona Reservoir. In fact, the water level limited Discount's access to the boat ramp and parking lot for most of the 1969 building season.

Prior to the resumption of work for the 1969 season, Discount and the Government's representatives had two conferences to decide on the best way to proceed with the removal of the nonconforming structures and to plan the remaining work under the contract. The contractor agreed to wait until September 1969 (when the boat ramp would no longer be under water) to work on the allegedly nonconforming structures but to begin its campground construction on June 2, 1969.[4]

On June 2, the contracting officer submitted to Discount a change order which designated an alternative borrow site and also gave plaintiff a partial work resumption order for the campground construction agreed to at the second pre-season conference. Plaintiff returned the order unsigned and alleged that it could not proceed because of problems

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[2] One such problem, a continuing source of friction between the parties, was plaintiff's contention that a designated borrow pit site held so much unsuitable material that it represented a changed condition. See Plaintiff's Exhibit 5, Letter of July 31, 1968. The contracting officer denied plaintiff's changed condition claim and plaintiff appealed to the Board but the issue was not resolved during the 1969 construction season involved here.

[3] The Government claimed that the ramp and lot were nonconforming because the contractor used unsuitable materials and methods in their construction. During the period October, 1968 through July 18, 1969, the parties negotiated an "as is" acceptance of the structures. On July 18, 1969, Change Order No. 5 was issued and the "as is" acceptance confirmed. The record indicates that Discount was fully aware of the ongoing negotiations and was fairly certain of the outcome by the first week of July, 1969.

[4] While access to the Lookout Boat site was precluded by the rising water level, conditions at the campground permitted work to resume at any time during the 1969 season.

with the Government's restaking of the area and certain clearing and grubbing difficulties. When the restaking was completed, the work order was reissued and signed on June 24, 1969, effective the next day. No work, however, was begun on the campground.

On July 14, 1969, the Forest Service ordered a full resumption of work, effective July 15. This full work resumption order took into account the Government's anticipated "as is" acceptance of the boat ramp (*see* footnote 3, *supra*) and required work to resume on all other phases of the project (particularly the campground). Despite this order (and the previous partial resumption order of June 24), which required work on the campground area (unaffected by the high water level), the Government alleges that no substantial amount of work was performed on the job site during the summer of 1969. Because of this alleged lack of progress, the Government, on July 23, 1969, sent Discount a 10-day cure notice demanding that work be resumed so as to ensure the project's completion before the expiration of the total contractual time remaining. It also requested a schedule for the work not yet begun or completed. When Discount neither resumed work nor provided a schedule, the contract was terminated for default on August 12th.

It should be inserted here that an additional point of contention between the parties arose during the summer of 1969. In June of that year, the Government submitted to plaintiff Pay Invoice No. 6, representing an estimated progress payment for work done in the previous year. Plaintiff disputed the estimated percentage of work completed and refused to sign; when the parties finally agreed, on August 4, 1969, to the amount due, the Government decided that Discount was in default of the 10-day cure notice, and was likely to be terminated; payment was therefore withheld to protect the sureties. This dispute over Pay Invoice No. 6 has resurfaced as an important point in the Trial Judge's decision and in the Government's objections to it.

Unlike the Trial Judge, we consider that the Board's factual findings were neither arbitrary, capricious, so erroneous as to imply bad faith, or unsupported by

substantial evidence in the record as a whole—and that the Board's ultimate determination was permissible. The fundamental issue before the administrative tribunal, and now before the court, is whether Discount made so little progress on its contract in the summer of 1969 that a default termination was justified. The Government's notice of termination stated that at the time it defaulted Discount the extent of plaintiff's work was inadequate indication of the diligent performance required to assure completion of the project within the contractual time. The Board found that plaintiff failed to perform sufficient work during the summer of 1969 and that its failure was unexcused, and then concluded that based on Discount's entire performance the termination was warranted. We hold these determinations to be adequately supported under the Wunderlich Act.

First, the record demonstrates that the Board could allowably find that, despite two resumption-of-work orders and plaintiff's assurances that work would soon resume, no substantial progress was actually made on campground construction during the 1969 work season. As of August 4, 1969—weeks after the order to resume work had issued and a day after the 10-day cure notice had expired—plaintiff had neither begun more-than-piddling construction activities at the campground, nor assured the Government that it could meet the completion deadline. Nor was any substantial work thereafter undertaken. The significant job left to do was the preparation and completion of the campground, and there was sufficient affirmative proof that Discount did practically nothing toward that goal.[5]

[5] For instance a contemporaneous memorandum (by the contracting officer's administrative representative) of a meeting of July 31st stated: "In regard to clearing and grading, Mr. Norelius [plaintiff's chief officer] said, 'He will take the necessary steps for preparations, starting on Monday, to resume work.' * * * I emphasized to Mr. Norelius that all phases of work with the exception of the boat ramp were available and suitable for a resumption of work and the Government's position was that there was no reason why work could not be resumed in full. Mr. Norelius stated that he is preparing for a full resumption of work on all phases within the next two weeks and that his continuation of work on this contract will depend on talks he is to have with his bonding company on August 1."

Another contemporaneous memorandum by the same Government official describes a second conference at the site on August 4th, a day after the expiration of the 10-day cure notice:

"We then discussed the planned resumption of work in relation to remaining

Plaintiff impliedly admits as much when it repeatedly says in its brief that it could not grade the campground without borrow, but that it had no proper place from which to obtain borrow (a cardinal point we discuss later). Discount did do some minor work on other aspects (*e.g.* on a waterline and some plumbing) but there is very little doubt that it performed little or nothing on the central component—the clearing and grading of the campground.[6]

The next question is: did the contractor have adequate justification for this failure to make progress on the campground work? Before the Board and the court, plaintiff has contended that progress was impeded because of the unsuitability (allegedly amounting to a changed condition) of the material at the originally designated borrow site. The borrow site problem was disputed throughout 1968 (*see* footnote 2, *supra*), and in June 1969 a change order was issued designating an alternative site for the contractor's use. It is worth noting, however, that the material at the initial site was not so unsuitable as to make performance impossible and the contractor therefore had a duty to continue performance during the processing of its claim. *See, e.g., Penker Constr. Co. v. United States*, 96 Ct. Cl. 1, 37 (1942). In fact, that part of plaintiff's work which required material from the first site (*i.e.*, the boat ramp) was accepted "as is" by the Government. *See* footnote 3, *supra*. The first borrow site seems to have been no longer wholly available in the summer of 1969 (because partially

contract time. Mr. Norelius was completely noncommittal as to any definite plans other than the testing of that section of the waterline already installed. I attempted over a period of approximately one hour to get a firm commitment from Mr. Norelius as to planned equipment and manpower and his schedule of completion of the project. He stated continually that he would commence to make the necessary preparations to resume work. It was apparent that he had no firm commitments at this time. I advised Mr. Norelius again that the 10 day cure period had expired and that we would have to make a decision regarding default of this contract. To be fair to him I would delay this decision one additional day provided he furnish us with a detailed schedule as to the proposed completion of the contract within the remaining time (approximately 46 calendar days remain). * * *"

[6] Discount complains about the stop order of July 2d prohibiting it from going ahead with the correction of the alleged deficiencies in the boat ramp, but, as we have indicated (footnote 3, *supra*), that order was issued because the Government was about to accept the boat ramp "as is"—and plaintiff knew that this was so. Furthermore, this stop order had very little to do with the work on the campground which was still open to plaintiff. These were different aspects of the contract work.

covered by water), but the remaining borrow material needed for the 1969 campground construction could readily have been taken from the alternate site designated early that June.[7] The plaintiff's only answer is that it rejected this proposed change order and was never officially ordered to use the alternate site. Discount's objection was not that the new borrow was unusable—on the contrary, it is quite clear that it was adequate—but that the change order should include an upward equitable adjustment because of higher transportation costs.[8] This is precisely the kind of controversy to be handled under the "disputes" mechanism by appeal to the Board if necessary. Meanwhile plaintiff was required by its contract to continue performance under the change order. *See Penker Constr. Co. v. United States, supra.* But, Discount now says, the change order was merely a proposal, the defendant never took the further step of unilaterally ordering it to use the alternate location despite its objections, and without such a further unilateral order the contractor would have waived its right to the equitable adjustment it desired. This hypertechnical contention—wholly divorced from the realities of the situation—can hardly be accepted as a proper excuse for refusing to make use of the alternate borrow site. In the circumstances here, it is immaterial whether the designation of the new borrow place was merely a government proposal or a fully operative and effective change order. Plaintiff knew that the designation of the alternate borrow site came to it in June 1969 on a form labeled "Contract Change Order Or Data Sheet Covering Amendments" as "Change Order Number 3"; it also knew that the new site was available, that the Government was willing to have it used and wanted it used if it became the only suitable borrow open to the contractor. Moreover, plaintiff was aware, or should have known, that it could have protected its right to an equitable adjustment by simply saying so—that it would comply with Change Order Number 3 but would still pursue its alleged right to an increase in the

[7] The Government also offered to select still another borrow site. [Footnote added per order May 27, 1977.]

[8] The change order, as transmitted by the Government, provided for no increase in the contract price.

contract price. Plaintiff never asked for the additional unilateral order it now calls an absolute prerequisite, nor did it tell the defendant, when it was being repeatedly pressed in the summer of 1969 to proceed with the work, that the main obstacle was that it could not safely use the alternate borrow site without such an additional order. We must infer that this excuse, the major one proffered us, is an afterthought, not a real justification for failing to proceed with the campground work in the 1969 summer.

Discount also has insisted that construction during the 1969 season was impeded due to an alleged failure by the Government to properly restake the area. There is, however, enough evidence (though not undisputed) showing that the Government agreed (at the pre-work conferences) to restake the area and that this work was sufficiently completed in mid-June. The Mona Campground construction, scheduled for the 1969 season, could have gone forward by the end of that month. Accordingly, the Board's finding that the staking difficulties did not preclude Discount's resumption of work throughout the entire season is supported by substantial evidence.

There are other assertions made on plaintiff's behalf to demonstrate that the default termination was improper. One is that the termination, which was in effect one for anticipated failure to complete, was wrongful because the contractual time had not yet run. The Trial Judge distinguished the instant case from those in which the contractor was already at the end of the contract's time period when the termination notice issued. Of course, the distinction is factually correct but the default clause in this contract did not require a finding that completion within the contract's time limitations was impossible. Rather, under this contract default termination was appropriate if a demonstrated lack of diligence indicated that the Government could not be assured of timely completion. It is therefore proper, once this lack of diligence has been found, to rely upon cases involving abandoned or repudiated contracts, as well as other decisions similar to the one at bar which have upheld "failure to make progress" terminations. *See, e.g., Universal Fiberglass Corp. v. United States*, 210 Ct. Cl. 206, 537 F.2d 393 (1976); *American*

Dredging Co., ENGBCA 2920, 72-1 BCA ¶9316, *aff'd*, 207 Ct. Cl. 1010 (1975).[9]

The Trial Judge also found that, because the contractual time had not yet expired, Discount was in fact wrongfully terminated on a technicality—its failure to provide a work schedule at the last hour (requested by the contracting officer but not explicitly required under the contract) outlining proposed plans for further work progress. The record is plain, however, that the default termination was not based on this demand *per se* but rather on the over-all evidence of Discount's failure to prosecute diligently its work under the contract. The function of the work schedule was to show that the contractor was ready, willing and able to make progress; Discount's failure to furnish such a schedule merely served to bolster the Government's position that it was justifiably insecure about the contract's timely completion.

Another contention on plaintiff's behalf is the effect of the much-disputed Pay Invoice No. 6. Discount did not directly contend, either in its brief or on oral argument before us, that the Government's failure to pay the full amount requested by plaintiff precluded it from proceeding during the 1969 construction season. Further, the Board determined that there was no evidence before it sufficient to prove that the failure to proceed under the contract was connected with Discount's non-receipt of government payments. The Trial Judge, however, emphasized Discount's financial difficulties and found that the Government's refusal to pay under Invoice No. 6 so severely hampered plaintiff's performance that its lack of progress was excusable. We do not think that this conclusion can stand against the Board's contrary finding. If the plaintiff had been in dire financial straits it could have accepted the amount offered under the invoice and disputed the remainder. In addition, this court has held that financial

[9] Because their facts were so different from those we must accept here, neither *Dale Constr. Co. v. United States*, 168 Ct. Cl. 692 (1964), nor *Schlesinger v. United States*, 182 Ct. Cl. 571, 390 F.2d 702 (1968), is pertinent. In the first, the only permissible finding was that a ready, willing, and able contractor was terminated, not for lack of diligence, but because it had submitted a claim for extras. In the latter, the Navy failed to use its own discretion whether or not to terminate but simply buckled under pressure from Congress.

difficulties create excusable delays only if precipitated by Government actions.[10] The non-payment here was not as a result of the Government's wrongful withholding of money clearly due but rather resulted from a good faith controversy, which was handled through appropriate channels, over the amount owed. It is true that the amount was finally settled on August 4, 1969, but defendant still refused to pay because the 10-day cure period had expired and the Forest Service personnel felt that the contract was likely to be terminated for default. We do not decide whether or not the Government was right in retaining the check at that late point for the benefit of the surety[11] because it seems clear that the failure to pay after August 4th did not trigger plaintiff's default which, as the Board found, had already existed and continued for some time.[12]

There is one final point to be mentioned. The Trial Judge has raised the issue of Government prejudice against plaintiff and has suggested that this prejudice tainted the default termination. Although it is obvious that theirs was not a friction-free relationship, the contractor did not argue prejudice before the Board or the Trial Division of this court. The Trial Judge does not point to any evidence in the record (except perhaps Discount's own accusations of prejudice in very late self-serving letters to the contracting officer) sufficient to meet the high burden of demonstrating the Government's bad faith.[13] On the contrary, this assertion of prejudice seems to us unfounded in the record. The Government officials appear to have acted in the full and honest belief that plaintiff had no proper excuse for failing to go forward with the work, and at the very least they had much support in plaintiff's attitude and actions. As for the Board, though it decided this case against

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[10] *See, e.g., Litchfield Mfg. Corp. v. United States*, 167 Ct. Cl. 604, 338 F.2d 94 (1964).

[11] The surety had not requested that the payment be withheld but there had apparently been some claims by suppliers (and others) of unpaid bills.

[12] After August 4, plaintiff does not appear to have inquired about payment of Invoice No. 6 until the afternoon of August 11. The termination was the very next day, August 12.

[13] *See, e.g., Knotts v. United States*, 128 Ct. Cl. 489, 492, 121 F.Supp. 630, 631 (1954), that the presumption of official good faith can be overcome only by "well nigh irrefragable proof."

Discount (as we have held, allowably so), it determined another appeal, very shortly before, in its favor.[14]

In sum, we accept the Board's findings and conclusion, as our review of the case reveals that the Board's determination was supported by substantial evidence on the record and is in harmony with relevant contract law. The Board's decision is therefore affirmed. Defendant's motion for summary judgment is granted, plaintiff's motion is denied, and the petition is dismissed.

KUNZIG, *Judge*, dissenting:

I respectfully dissent from the majority opinion. I would adopt the opinion of Trial Judge Browne, which follows hereafter:

BROWNE, *Trial Judge:* This case comes before the court for judicial review, under the provisions of the Wunderlich Act,[1] of a decision of the Board of Contract Appeals for the United States Department of Agriculture (Board) dated June 25, 1974[2] and the denial of appellant's motion for reconsideration by the Board on September 26, 1974.[3]

Plaintiff, Discount Co., Inc., of Springfield, Oregon, was awarded Contract No. 002112 on May 20, 1968, by the Forest Service of the United States Department of Agriculture. The contract called for construction of a facility identified as "Mona Campground and Lookout Boating Site" in the Willamette National Forest, Lane County, Oregon. The amount of the contract was $104,399.99. Work was to be completed within 180 calendar days after receipt of notice to proceed. The contract was terminated by the Government by "Notice of Termination" dated August 12, 1969. The termination was based on anticipated default of the contractor, the time for completion not having expired as of the date of termination.

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[14] The plaintiff itself rejected (before the Board) the position that it was financially hampered on the instant contract by its problems on the other one.

[1] 68 Stat. 81, 41 U.S.C. §§ 321 and 322 (1970).

[2] AGBCA No. 273, 74-2 BCA ¶ 10,775.

[3] AGBCA No. 273, 74-2 BCA ¶ 10,855.

Dissenting Opinion by Judge Kunzig

Plaintiff seeks, in this case, to have the default termination be denominated as a termination for the convenience of the Government and that a determination be made as to the amount of equitable adjustment to which plaintiff would be entitled or, in the alternative, to recover in *quantum meruit* for plaintiff's services and to recover plaintiff's damages proximately caused by the Government's termination of the contract.

Plaintiff asserts that the decisions of the Board were:

1. Arbitrary and capricious;
2. So grossly erroneous as to imply bad faith;
3. Not supported by substantial evidence.

Plaintiff further asserts that the decisions of the Board were erroneous as a matter of law.

Defendant supports the Board's decision both as to the facts and the law.

I would find that termination was for the convenience of the Government and remand the case for determination of the amount to which plaintiff is entitled as equitable adjustment and damages.[4]

I. *Summary of Facts*

The Forest Service of the United States Department of Agriculture awarded Contract No. 002112 on May 20, 1968 to Discount Co., Inc., P. O. Box 17272, Portland, Oregon 97217 for "Construction of Mona Campground and Lookout Boating Site" in Willamette National Forest, Lane County, Oregon. The contract called for completion of the work within 180 calendar days after receipt of notice to proceed. Work was to commence within 10 calendar days after date of receipt of notice to proceed.

The contract called for, among other things, construction of a number of campground camp units, a boat-launching ramp and a parking area. The contract specified the location of a "Case I borrow source" from which the contractor could obtain fill to be used as a base for the boating ramp and the parking area. The composition of the material of the Case I borrow source was the principal

[4] 28 U.S.C. § 1491 (Supp. IV, 1974).

object of controversy throughout the period of the contract. The controversy over this matter was the proximate cause of the delay in performance by the contractor.

Shortly after the contractor commenced work, he found that the Case I borrow source contained a large amount of unsuitable material. The contracting officer ordered the unsuitable material to be removed and issued a work order to authorize the extra work. However, no provision was made in the work order dated June 28, 1968 for extra payment for removing the unsuitable material from the borrow source. By letter dated July 31, 1968, the contractor requested an increase of 87 cents per cubic yard to cover the increased cost of complying with the work order issued by the contracting officer.

In the same letter, the contractor requested, as an alternative, that another borrow source, containing the necessary amount of approved acceptable material, be provided and that equitable adjustment in payment and contract time be made.

Concurrently with the controversy over the suitability of the Case I borrow source material, a disagreement arose over a work order issued by the contracting officer dated June 28, 1968 requiring 32 fires to burn trees, down timber, stumps, brush, wood chunks and sticks removed from the Case I borrow. By letter dated October 3, 1968, the contractor requested payment for the additional work required to comply with this work order. By letter dated September 16, 1968, the Contracting Officer's Authorized Representative (COAR) advised the contractor that his claims for additional compensation for this work would not be approved.

When the contractor complained about the decision of the COAR, an investigation was made by the Contracting Officer's Representative (COR), Mr. Hickey, and Inspector Campbell. A report on the results of that inspection dated November 1, 1968 indicated that even though most of the unsuitable material from the borrow pit was piled in one corner of the borrow pit there were 20 small piles of debris around the parking lot and boat ramp.[5]

[5] These were 20 of the 32 sources of fires required by the work order.

It appeared to the inspecting team that the debris in the 20 piles resulted from a clearing of the boat ramp and parking lot areas and included a small amount of debris not required to be removed under the work order of which the contractor was complaining. The report also indicated that the inspecting team did not see any burning of any of the debris from the borrow material. In fact, their check of the record of the ranger district showed that the last burning permit issued to the contractor was for the period of July 16 to July 19 whereas the excavation of the borrow material did not start until July 24, 1968.

Work was suspended during the winter months of 1968–1969, during which time the progress made by the contractor was reviewed. A letter dated January 2, 1969 was sent to the contractor advising him of the results of the review to that date. Among other things, it was stated that:

> * * * there are one or two points that we feel should be brought to your attention as they will undoubtedly reflect on the scheduling of your work following the resumption of operations.

The report also stated that as of the suspension of work on December 18, 1968, 102 days of the 180-day contract period had been used (constituting 57 percent of the time allowed) and that 27 percent of the contract work had been completed. However, the report stated:

> According to your proposed progress schedule submitted on August 20, 1968, you are presently on schedule from an overall standpoint although some individual items are either behind or ahead of the schedule.

The report also indicated that, due to the schedule of the Corps of Engineers in filling the reservoir to which the boat ramp would lead, the lower end of the boat ramp would be under water around May 1, 1969. The report stated:

> This situation may present a problem in completing the contract on schedule and we ask that you give it your fullest attention.

The only item specifically mentioned as requiring early attention was a pile of debris, then located within the limits of the reservoir, since the water level would rise to that point "sometime late in March or early April."

No provision was made at that time for resumption of work before the level of water in the reservoir would reach the lower end of the boat ramp.

Finally, the report made the following request:

> * * * In order that we may program our workload and inspector needs, it would be appreciated if you would contact COR Hickey at your earliest opportunity and advise him of your detailed schedule for completion of the boat ramp and parking lot and also the completion of the clearing operations in the campground.

Thus it appeared that there was a truce in the "running battle" between the COR, COAR, and the contractor, which placed the contractor and the Government representatives on a new and amicable footing when the work would resume in the spring.

A "prework resumption meeting" was held at the site on May 14, 1969 "to review past work and discuss future plans with the contractor and his superintendent." Eight Government representatives attended the meetings along with the contractor and the contractor's superintendent.

Whereas it was anticipated that the water level of the reservoir at the boat ramp would reach a high elevation of 1,350 feet by about May 1, the water level reached an elevation of approximately 1,348 feet[5a] as of May 14, 1969 (thereby covering a major portion of the boat ramp).

The Government, upon completion of this inspection, contended that the placement of the borrow material in the boat ramp and parking lot was not in accordance with the specifications since it contained more than the allowable amount of unsuitable borrow and that the two areas, therefore, would not be acceptable in their state at that time. The minutes of the meeting as recorded by the COAR, with reference to the high water level, included the following statement:

> * * * Under these conditions the Government recognizes the impracticality of resuming work on this portion of the contract on a piecemeal basis. Therefore it will be the contractor's option to resume work on that area

[5a] The elevation was apparently stated erroneously as 1,648 feet in plaintiff's exhibit 8 and in the transcript at page 60.

available to him or delay all work on the Lookout Boat Site until the water level recedes, which is anticipated to be in the later part of September.[6]

The minutes further indicate:

> Mr. Angell [the contractor's superintendent] indicated that it was not planned to resume work on the boat ramp and parking lot until such a time that the water level was down and removal and replacement of fills could be a complete and continuous operation.

The position of the Government with regard to the suitability of the Case I borrow source remained unchanged as of the time of the meeting. The minutes indicate, however, that a second source previously not available to the Forest Service for its use, would be designated as an Alternate Case I source and could be used by the contractor. The minutes further state:

> * * * The alternate source was pointed out and examined. The limits of the source will be staked on the ground and a change order issued prior to resumption of work. The contractor may use either or both sources.[7]

The campground area was inspected and the minutes indicate that the ground conditions in that area were favorable and would permit work to resume at any time. However, clearing and construction stakes which were previously placed "to a great extent, were missing or destroyed." It was agreed that the Forest Service would replace the staking at no expense to the contractor, prior to the resumption of work. The restaking was to commence on May 20 with arrangements being made for the contractor's superintendent to meet with the COR at the site the following day, to view the staking operations and become familiar with the coding and placement of the stakes.

Upon completion of the staking, a controversy arose over lack of completion of the restaking by the Forest Service, making the resumption of work on May 26, 1969 impossible. (The minutes indicate that 78 days of the 180 days still

[6] The Government contends that all other work, except the "work on the Lookout Boat Site" was to proceed on full schedule in the meantime. The contractor understood that no work was required until all work could be done on a continuous basis.

[7] In the context of the minutes of the meeting, the alternate source would not be used until September, when work on the boat ramp would be resumed.

remained for the work to be completed under the contract as of that time.)

Although one pile of slash and debris (located northeast of camp unit No. 21) was partly covered by water from the reservoir and could not be burned until the water level receded (in September), the remainder of the clearing and grubbing could have continued without delay. In conclusion, it was mutually agreed that work would resume on May 26, 1969 on the campground, following completion of the restaking. The agreement to resume work, however, is somewhat inconsistent with the fact that it was impractical for the contractor to resume work on the boating site portion of the contract on a piecemeal basis, it being the contractor's option

> * * * to resume work on that area available to him or delay all work on the Lookout Boat Site until the water level recedes, which is anticipated to be in the later part of September.

A further meeting was scheduled for May 23, 1969 in the Forest Service office in Eugene, Oregon.

The further meeting took place as scheduled. The COR, the COAR, and the previous COR, as well as the contractor's superintendent, were present. At that meeting it was understood that the construction staking could not be completed until May 29, 1969 but that the clearing limit staking was nearly completed and would be completed by May 26, as scheduled.

It was mutually agreed that the resumption of work *on the campground* should be delayed until June 2, 1969. This was to permit the Forest Service crews to complete the restaking prior to resumption of work.

It was also agreed that the Alternate Case I borrow source would be staked and a change order issued prior to resumption of work. (Change Order No. 3, dated June 2, 1969.)[8]

The contractor's superintendent indicated that it was the contractor's intention to

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[8] No copy of this document found in record.

> * * * proceed immediately with all work available to him and accomplish that work in the shortest time possible and practical.

He also indicated that they might not start with all the equipment and men on June 2, 1969, but that, if not, they would be in full production shortly thereafter.

In the meantime, the dispute regarding the contractor's claim for clearing and grubbing of the Case I borrow source material was taken to the Board of Contract Appeals. While the minutes of the meeting do not specifically mention anything about the contractor's claim with respect to the borrow source material it appears that the intention was to use the alternate borrow source and yet, there was no comment on additional payment to be made to the contractor if the alternate borrow source was used.

The contractor's good faith and bona fide intent to resume and complete the work was illustrated by a statement in the minutes of the May 23, 1969 meeting to the effect that:

> Mr. Angell indicated that Discount Company intended to notify the local newspapers of their plans for resumption of work and request the public to stay out of the construction areas. They also intend to place warning signs and barricade the project area.

This entry is made under the heading "public relations." In further elaboration, the minutes state:

> In view of the public relations aspect of the project, Mr. Angell was requested to coordinate as much as possible with the Forest Service regarding signing and press releases. A joint effort by both parties can accomplish the purpose and maintain good public relations.

Notwithstanding the intentions of the parties to proceed with the work as soon as possible, it was not until June 25, 1969 that a "partial resumption" work order was issued. The document bears a typewritten date of June 2, 1969, but that date was obliterated and a handwritten date of June 25, 1969 was inserted. The order made reference to the prework conference of May 23, 1969 and carries a handwritten note "see Discount letter of 6/24/69" and what appear to be the initials of the COAR.

According to the testimony of the contractor (which appears to be uncontradicted) he proceeded to move equipment into the site on July 2, 1969 pursuant to the order to fully resume work as of June 25, 1969. The contractor testified with respect to his efforts to resume work on July 2, 1969:

> As soon as the equipment was on the site and it was started up, it started up at the boat ramp in preparation to move out the parking area, the COR on the project immediately gave us a work order directing us "no work is to be done on removal and replacement of rejected fills as presently in place in Lookout Point boat ramp and parking lot. This order is issued pending result of negotiations on a proposal being presented to your legal representative by the contracting officer. This proposal involves a conditional acceptance of the fills as placed."
>
> This was signed on the project site by the project superintendent at 3 p.m. in the afternoon, 7/2/69. It was taken immediately down to the equipment supplier and the man who was working bringing the equipment. He was told that he couldn't start up in that area. He signed this also.
>
> They told T & T Logging to stop at 3:15 p.m. They loaded up the loader and moved it out. It's signed by William R. Taylor.
>
> It stopped the operation right there.

Concurrently with the contemplated resumption of work, a controversy was running with respect to the amount of payment due the contractor for work already completed. In particular, the controversy revolved around the percentage of completion of specific items up to the time of resumption of work in the spring or summer of 1969.

A meeting was held with the contractor in Portland, Oregon, on July 14, 1969, at which time the contractor was advised that a total work resumption notice would be issued effective July 15, 1969. (A certified mail receipt indicates that the notice of total work resumption was received by the contractor on July 17, 1969.)

The work order, effective July 15, 1969, called for:

> Full resumption of work on all phases of the project *excepting* that portion of work, as it pertains to the Lookout Boating Site parking lot and boat ramp, presently being arbitrated * * *.

The document indicates that it was issued on July 14, 1969, and was mailed by certified mail to the contractor at P. O. Box 3, Springfield, Oregon 97477 on July 14, 1969. A copy of the notice was also sent to the contractor's attorneys, Robertson and Wills, 18448 Southeast Pine Street, Portland, Oregon 97233.

The record does not indicate what transpired during the week following July 15, 1969. However, by letter dated July 23, 1969 the contracting officer placed the contractor on notice that, unless work would be resumed by August 3, 1969 (10 calendar days after *receipt* of the letter, July 17, 1969) "with such diligence as to insure completion of the work within the remaining contract time" (57 calendar days then remaining according to the contracting officer's computations), the Government would have to consider termination of the contractor's right to proceed with the work and subsequently to terminate the contract for default.

The contracting officer's letter of July 23, 1969 which threatened to terminate the contractor's right to proceed and also threatened subsequent termination, failed to make reference to the effort of the contractor to resume work on July 2, 1969. Likewise, no reference was made to the stop order which precluded the contractor from proceeding to take out and replace the boat ramp and the parking area borrow while the Government was reconsidering its prior refusal to accept those portions of the work. Meanwhile, time was running against the contractor since the partial resumption order was effective June 25, 1969.

Prior to this time, apparently without knowledge of the contractor, the Government had already decided to accept the boat ramp and parking area "as is" and make a contract adjustment accordingly. It was not until later that the contractor was advised that the Government had decided to accept the boat ramp and parking area "as is," thereby relieving the contractor of any further responsibility for that portion of the contract.

Having received the letter of July 23, 1969 from the contracting officer, the contractor met with the COAR on July 29, 1969 to discuss the status of the contract. The

contractor indicated that his superintendent had not been furnished adequate information to permit him to resume work and that the matter of payment for work completed had not been resolved.

The contractor also discussed the matter of using the Alternate Case I source for completing the work on the boat ramp and parking area. He was concerned lest he would not be compensated adequately for hauling the fill from the Alternate Case I source since nothing was mentioned in the change order concerning such compensation. He was advised by the COAR that the change order would be revised to provide for compensation. He asked that he be compensated at a rate of 30 cents per cubic yard. The COAR told him that he could see no problems involved in that revision since if this was the only thing standing in the way of resolution of the problem, the Government would be agreeable.

Even this discussion apparently did not take into account the fact that the Government had already decided to accept the boat ramp and parking area "as is." Otherwise there would have been no reason to discuss the alternate borrow source.

The contractor thereafter telephoned the COAR on July 31, 1969, requesting a meeting at 4 o'clock that afternoon to discuss the pending claim for payment for work completed. Upon inquiry by the COAR as to the status of the contractor's resumption of work on the project, he was advised by the contractor that work would resume at 8 a.m., Monday, August 4, 1969. It was indicated that the contractor intended to resume work on the waterline construction and the grading of the campground roads. He did not intend at that time, to resume any work on the boat ramp or parking lot, it being understood that such work would not be resumed until the water level was expected to recede in September (the contractor still being unaware of the Government's decision to accept the boat ramp "as is"). The contractor also indicated that work on the waterline could not be resumed before August 4 because his plumbing subcontractor was tied up on another job. Furthermore, the contractor said he could not resume work

on the grading until he reviewed the change order, on the site, before any stakes were disturbed.

The meeting was held the afternoon of July 31, 1969, as scheduled. Both the COR and the COAR were present. An agreement was reached as to their differences regarding the percentage of work already completed in connection with the contractor's claim for payment for such work. The contractor was advised that the revised pay estimate would be submitted to him the following Monday morning.

Thereafter, the discussion related to resumption of work. The contractor repeated his earlier representation that waterline construction would start on Monday, August 4, at 8 a.m., and, with regard to clearing and grading, he would take the necessary steps for preparations, starting on Monday, to resume work.

It was further agreed that construction on the water tank would start after the waterline had been tested, the ditch backfilled and access to the site provided. The COAR took the position that all phases of work, *with the exception of the boat ramp,* were available and suitable for resumption of work and that "the Government's position was that there was no reason why work could not be resumed in full."

The contractor took the position that he would be prepared for a full resumption of work on all phases *within the next 2 weeks, i.e.,* by August 14, 1969. He further conditioned his representation on the outcome of talks he was to have with his bonding company on August 1, 1969.

The contractor was informed that the COAR and the COR would be present on the site at 8 a.m., Monday, August 4, to determine whether or not a conscientious effort was being made to resume work on the contract. Other minor matters were discussed during the conference, such as the location at which the contractor would dispose of large rocks and other material dug up during correction of the fill slopes. These matters, however, were of no consequence overall.

The COR (Davis) arrived at the site at 8:05 a.m., on August 4, 1969, as scheduled. The contractor's superintendent, Angell, and two employees were there also. Shortly thereafter, the contractor (Norelius) arrived, as did the

plumbing subcontractor, Hope, and one employee. All except the COR and Norelius proceeded to repair a break in the 6-inch waterline and to install a T connection which had been omitted in the earlier construction.

The plumbing subcontractor had scheduled ditching of the remainder of the waterline. However, upon reviewing the site on August 3, 1969 (the previous day), he found that the staking was not complete. Thereupon he cancelled the order for the equipment to complete the trenching pending replacement of the missing stakes. The COR and the contractor's superintendent later found adequate stakes in place in the area.

The COAR advised the contractor that approximately 46 calendar days remained for completion of the contract and requested a schedule of completion of the contract. The contractor was reminded of the fact that the 10-day "cure period" prescribed in the letter dated July 25, 1969, had expired but he would be allowed an additional day (to the close of business on Tuesday, August 5, 1969) to furnish a detailed, day-by-day schedule of proposed completion of the contract within the remaining 46 calendar days. The contractor asked that he be allowed until Wednesday, August 6, 1969, to submit the schedule since he would be busy lining up equipment on Tuesday, August 5, 1969. This request was refused by the COAR. *In conclusion, he was informed by the COAR that if he hesitated to resume work and thereby jeopardized completion, the contract would be terminated.*

The record indicates that the contractor was preoccupied with the matter of collection of the money due him for the work already completed. It further appears that the bonding company and the contractor's creditors were likely to be the beneficiaries of any money received, thus virtually eliminating any incentive for the contractor to put out the additional funds to complete the contract.

It is equally evident from the record that the Government was less than fair in its treatment of the contractor in that it held up payment of the amounts due for completed work as a means of forcing the contractor to submit a detailed, written schedule of completion. *There is no indication, however, that the contract would not have*

been completed within the number of days remaining for completion.

The contractor, by letter dated August 5, 1969, wrote the COAR as follows:

> On the Project this Monday I explained the Methods and procedures that would be used for completing this project with the existing changes and changed conditions. You stated the government was aware of all conditions and felt that an accellerated [sic] schedule should be implemented. This schedule is under preparation and will be submitted very shortly.
>
> The change orders I received Monday are being processed and appear favorable.
>
> We will continue to proceed diligently with performance of this contract.
>
> If there are any questions, please do not hesitate to contact me.

The letter did not convince the COAR that the contractor's expressed intention to "continue to proceed diligently with performance of this contract" was supported by any overt showing of likelihood of accomplishment. Notwithstanding the contractor's promise to submit "very shortly" an accelerated schedule of completion (already under preparation), the COAR, by letter dated August 7, 1969, warned the contractor that "[v]isible action or lack of action on your part will determine the necessary course of action to be taken by the Contracting Officer."

The record[9] indicates that the contractor telephoned the COAR on the afternoon of August 11, 1969, regarding the payment being withheld by the Government. The COAR could not give an immediate answer as to the status of payment but agreed to call back within an hour (by 3 p.m.). The contractor indicated he would call back in 2 hours (by 4 p.m.). Instead, the contractor's superintendent called the COAR in behalf of the contractor at about 4:30 p.m.

The COAR informed the contractor's superintendent that *payment was being withheld pending the decision by the contracting officer (CO) on termination of the contract,* which decision was expected to be made by noon the next day, August 12, 1969.

[9] Memorandum to Files, prepared by COAR on August 14, 1969 (3 days after the occurrence of the events recited therein and 2 days after the "Notice of Termination" was sent to the contractor).

At about 8 p.m. the evening of August 11, 1969, the contractor phoned the COAR at his home to obtain verification of the message given him by his superintendent. The COAR verified it and confirmed that he, alone, had made the decision (in the absence of the CO, and with full knowledge of the acting CO) to *withhold payment for completed work pending the decision of the CO on termination.*

The next day (August 12, 1969) the contractor replied to the letter from the COAR, sending a copy to the CO. The letter reads as follows:

> These facts occured [sic] with the pay estimate while you were on vacation and are presented to you for corrective action, as stated in our meeting this morning.
>
> As you know, pay estimates have been delayed for various invalid reasons on our projects. We have been trying to complete the evaluation agreed to be made at the project site meeting of May 14, 1969. The Forest Service took exception to the results of previous evaluations and on July 31, I met with Mr. Roth and Mr. Davis and using the Forest Service calculations the present evaluation was arrived at.
>
> I asked for prompt processing of the pay estimate and Mr. Roth said it would be ready Monday August 4th for signing and processing, and it was signed by Mr. Angell and Mr. Davis for processing and payment.
>
> On August 11th, I phoned Mr. Roth and asked him if this estimate had been processed. He stated he would check on it, later this same day Mr. Angell phoned Mr. Roth and was told this pay estimate was being held up by Mr. Roth pending possible termination of the contract by Mr. Donkel.
>
> When Mr. Angell informed me Mr. Roth had been holding up this pay estimate, and realizing the deception involved, I phoned Mr. Roth and he then informed me he had retained this pay estimate because we had not notified him of action taken regarding unpaid obligations and claims against the bonds and he was awaiting the decision on terminating the contract. He was therefore not processing this estimate agreed upon July 31, 1969.
>
> This deception with the pay estimate by Mr. Roth required me to reschedule the planned equipment being moved to the project for a more compatible date. The uncertainty of the Forest Service activities made this necessary.

The participation of Forest Service Officials to deliberately apply economic pressure in this deceitful manner of holding up pay estimates, which the Forest Service apparently did not intend to honor, certainly is unethical and deceitful and requires corrective action.

On August 4th at the project Mr. Roth demanded an accelerated performance schedule by the next day. I told him the time allowed was unrealistic to prepare a detailed schedule but would have one within two weeks. The answer to his letter of August 7, 1969 is being prepared also.

On August 14, 1969, the contractor wrote a separate letter to the CO, sending a copy to the COAR. The full text of this letter is as follows:

In reply to your letter of August 7, 1969, the facts should have been stated by you more accurately.

You observed that we were proceeding diligently in the only area available for us to proceed in an orderly sequence, because the Forest Service had not provided the essential cooperation and follow up of their agreements promised us, so construction could prevail in an orderly manner in a continuous effective operation.

Men and equipment would have been performing on the parking area water installation system had the Forest Service completed the staking they assured us they would do. However, water line work was being performed in the only areas available, to the tank site.

The builder will complete his work when the tank site is available for work after this section of water line is completed.

Boat Ramp and Parking Area work was curtailed because high water made it hazardous, and impractial [sic] to perform work there.

In the campground on Monday August 4, 1969 was the first time the changes were inspected jointly, even though we had previous [sic] requested your cooperation to review these changes, to facilitate prompt resumption of contruction [sic]. Construction could not feasibly proceed until this joint inspection of campground changes.

The above was adequately explained to you on the project, and you acknowledged understanding the conditions created by the Forest Service, I was thereby astonished when your letter did not indicate the correct discussion. It appears that your prejudice overcomes a proper judgement [sic] of this project.

As of August 14, 1969, the contractor apparently had not received the "Notice of Termination" issued by the CO on August 12, 1969. The text of that notice is as follows:

Reply to: 6320 Contracting August 12, 1969

Subject: Notice of Termination, Mona Campground and Lookout Boating Site, Bid No. R6–68–183, Contract No. 002112

To: Discount Company
P.O. Box 17272
Portland, Oregon 97217

CERTIFIED MAIL—RETURN RECEIPT REQUESTED

By Certified Mail, dated July 23, 1969, and receipted for by E. E. Angell, Vice-President and Project Superintendent, at 8:30 a.m. on July 24, 1969, you were advised "we are placing you on notice that if work has not been resumed on this contract within ten calendar days after receipt of this letter with such diligence as to insure completion of the work within the remaining contract time, we will have to consider termination of your right to proceed with the work, and subsequently terminate the contract for default."

The ten-day period specified for returning to work expired August 3, 1969. During this period you did not perform any work on the project site. Subsequent to this period you have only performed minor work testing and repairing previously installed water lines. The extent of this work is inadequate evidence of the diligent performance required.

The letter of July 23, 1969 reiterated some of the events and circumstances related to your failure to return to work on this project during the current work season which are cause for the termination of this contract for default.

Subsequent to the expiration of the cure period allowed on August 4, 1969, you met with Wm. H. Roth, Contracting Officer's Administrative Representative on the project site to discuss your possible return to work. The documentation of this meeting was sent to you by Mr. Roth's letter of August 7, 1969. A copy of this letter is attached. To date you have not furnished the Government with any proposed schedule of your plans

Dissenting Opinion by Judge Kunzig

for completion of this project to in any manner assure us of possible completion within the remaining contract time.

As of the close of business this date you have not resumed work in such a manner as to assure completion of this contract within the remaining contract time. Considering these facts, it is my determination to terminate this contract for default.

Your right to proceed further with the performance of the contract is terminated effective at close of business this date, August 12, 1969, or date of receipt of this notice, or notification thereof, whichever is later.

The Government may cause the contract to be completed and you, the contractor, will be held liable for any increased costs.

The Government reserves all rights and remedies provided by law and under the contract, in addition to charging increased costs.

This notice constitutes my decision, pursuant to the Disputes clause, that you are in default as specified and I have determined that your delay in prosecution of the work is not excusable.

This decision is made in accordance with the Disputes clause and shall be final and conclusive as provided therein, unless, within thirty days from the date of receipt of this decision, a written notice of appeal addressed to the Secretary of Agriculture is mailed or otherwise furnished to the Contracting Officer. The notice of appeal, which is to be signed by you as the contractor or by an attorney acting on your behalf, and which may be in letter form, should indicate that an appeal is intended, should refer to this decision and should identify the contract by number. The notice of appeal may include a statement of the reasons why the decision is considered to be erroneous.

ROBT. L. DONKEL
Contracting Officer

cc: Robertson & Wills

Attorneys at Law
18448 S. E. Pine
Portland, Oregon 97233

United Pacific Insurance Co.
415 S. W. 10th Avenue
Portland, Oregon 97201

Discount Co.
P. O. Box 3
Springfield, Oregon 97477

COR Charles Davis, Willamette NF
COAR William H. Roth, Willamette NF
Willamette NF (B&F)
Willamette NF (6320)

It is in the context of the foregoing climax to the contentious relationship between the contractor and the Government representatives that the ultimate issue must be decided. Due regard being given to the Board's findings of fact in this case, the court must ultimately decide whether or not the Board erred in refusing to hold, as plaintiff urges, that the termination for default should be treated as a termination for convenience of the Government.

The August 14, 1969 memorandum of the COAR's recollection of this telephone conference (see note 9), perhaps more than any other single document in the case, places in focus the ultimate issue in this case.

The question comes down to this:

May the Government withhold payment of amounts due for completed work, yet terminate the contract unilaterally for failure of the contractor to submit, by a specified date, a "detailed plan for accomplishment of the remaining work within the remaining contract time" in the absence of evidence which would clearly establish impossibility of completion on time?

II. *Summary of the Law*

no case has been cited by the parties which is more nearly in point than this court's decision in *Dale Constr. Co.* v. *United States*, 168 Ct. Cl. 692 (1964). In that case the court, *per curiam*, adopted the opinion, findings and recommendation of the "trial commissioner." The essential portions of that opinion are summarized hereinafter.

Dale contracted with the Army to replace a 16-inch cast iron water main at the Boston Army Base with a new main made up of a combination of 16-inch cast iron pipe and 16- and 12-inch cement-asbestos pipe. Start of the contract was delayed due to unavailability of the cast iron pipe.

However, construction was ultimately started, using the available cement-asbestos pipe pending availability of the cast iron pipe. Further delay was caused by the failure of the Boston City Water Department to close a specified valve (the specified valve being imbedded in the street, and therefore not visible) before excavation was commenced. When excavation was commenced, the trench and adjacent areas were flooded. The contractor's claim for his loss due to the flooding and delay was denied by the CO.

Dale continued work on the cement-asbestos pipe section until freezing weather (at the end of December) necessitated cessation of the work. The work was resumed, however, the following March.

There followed other delays such as the refusal of the Army to prevent its employees from using the work area as a parking lot. Without enumerating all the other claims for delay, suffice it to say that the relationships between the contractor and the Government representatives deteriorated to the point that all communications between the contractor and such representatives had to be channeled through the office of the CO.

Finally the contractor and the Government representatives reached an impasse. The crisis arose over the matter of installing sheathing in the trench in which the pipe was installed. On the same date the contractor wrote to the CO concerning resumption of work, the CO sent the contractor a letter terminating the contract for default and terminating further performance under the contract.

In reaching the conclusion that there was no justification for cancelling the contract for default, the "trial commissioner" stated:

> Withal, it appears that the major reason for the termination was not the contractor's lack of diligence but rather its submission on January 12, 1952, of a claim for extras. * * * [*Dale Constr. Co.* v. *United States, supra,* at 720.]

The facts in the present case are somewhat analogous to those in *Dale, supra.* In the present case the contractor had a claim pending for payment of work completed and a claim for additional payment for moving material from the

alternate borrow source. Also, the matter of acceptance of the boat ramp "as is" was under negotiation.

In the present case there is also evidence of antagonism between the contractor and the Government representatives. The record indicates that one Government employee with whom the contractor had difficulties was taken off the job in order that the conflict would cease.

Finally, the CO in the present case made no finding that the contractor was actually in default on any item. His only ground for termination was that there was "inadequate evidence of the diligent performance required." In further elaboration on this point, the CO stated that "some of the events and circumstances related to your failure to return to work on this project during the current work season which are cause for the termination of this contract for default" were set forth in the 10-day "cure" letter of July 23, 1969.

In a somewhat redundant and petulant manner, the CO stated in the notice of termination:

> * * * To date you have not furnished the Government with any proposed schedule of your plans for completion of this project to in any manner assure us of possible completion within the remaining contract time.

The notice went on to say:

> As of the close of business this date you have not resumed work in such a manner as to assure completion of this contract within the remaining contract time. Considering these facts, it is my determination to terminate this contract for default.

Nothing was said in the letter about payment for completed work, the acceptance of the boat ramp "as is," or any other matters outside those referred to in the "cure" letter of July 23, 1969.

Another precedent of this court which is applicable to the present case is *Schlesinger* v. *United States*, 182 Ct. Cl. 571, 390 F.2d 702 (1968).

In *Schlesinger*, a "cure" letter was sent to the contractor which concluded with the following paragraph:

> This letter notice is your first warning concerning delinquency in deliveries of Caps, service, under the subject contract. You are requested to immediately

advise the Contracting Officer the specific dates on which deliveries can be expected. Upon receipt of the information further determination will be made regarding the status of your contract.

Without making a finding that the contractor would not have been able to complete the contract within the time allowed, the Government thereafter terminated the contract for default. The Armed Services Board of Contract Appeals sustained the termination for default but the Court of Claims held that the termination should be for the convenience of the Government. It is clear from the court's opinion that the Government seized upon a technicality to terminate the contract for default, whereas exercise of sound discretion would have dictated termination for convenience of the Government under the facts in the case.

By analogy, the CO in the present case seized upon a technicality as an excuse to "get rid of the contractor." The technicality in this case, as in *Schlesinger, supra*, was the failure to submit a written schedule for completion of the work—and nothing more. Nowhere in the contract in the present case is there a provision for submission of completion schedules other than those required at the time of commencement of the work (Contract § 4.3).

The present case is readily distinguishable from those cases in which the contractor was already in default at the time of issuance of the "Notice of Termination" by the CO.[10] This is a case in which the CO *anticipated* a default but without making a determination that the contractor could not possibly complete the work *within the time remaining.*

Finally, the CO was not lawfully entitled to withhold payment of sums due the contractor for work completed or to pay over such sums to the bonding company where the contractor was not already in default or where there is insufficient evidence to establish that the work could not possibly be completed within the time remaining.

In *Hicks Corp.* v. *United States*, 203 Ct. Cl. 65, 487 F.2d 520 (1973), the contractor closed its plant due to lack of operating funds and thus was in default at the time of

[10] *See, e.g., Litchfield Mfg. Corp.* v. *United States*, 167 Ct. Cl. 604, 338 F.2d 94 (1964).

termination. Thus the CO was justified in terminating the contract for cause.

The contractor in the present case was obviously in a financial "bind." The bonding company and some creditors had made known to the Government their concern over the ability of the contractor to fulfill his financial obligations. They showed no concern, however, over the ability of the contractor to *complete the work* within the remaining time. They were only concerned about the cash flow. To this extent, the Government was at fault for deliberately withholding the amounts due the contractor for work completed. Had such amounts been paid, the concern of the bonding company and creditors of the contractor may have been alleviated or, perhaps, eliminated.

Beyond a shadow of doubt, the attitudes and actions of the CO in terminating the contract, and the Board in affirming the termination, reflect a prejudice against the contractor arising out of a pending controversy with the same contractor over another contract which was also terminated for default, but was ultimately converted to termination for convenience of the Government after appeal.[11] Indeed, the decision of the Board from which the present appeal has been taken clearly states:

> The difficulties at North Waldo experienced by appellant and for which this Board found that the Government was responsible undoubtedly had some effect upon appellant's difficulties in the contract which is the subject of this appeal. * * *

The fundamental error of law in the Board's decision in this case lies in its statement that:

> It is not a sufficient answer that there was adequate time left for completion. It seems clear that at the time of termination there was adequate time left for completion. * * *

The Board stated further:

> * * * There is no evidence in this appeal showing a connection between the failure to prosecute the work and financial difficulty arising out of Government action on this contract or on the contract in Appeal No. 291, *supra*.

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[11] Discount Co., AGBCA No. 291, 74-1 BCA ¶ 10,511.

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Since there was adequate time left for completion of this contract at the time of termination and the Government not only wrongfully withheld payment of amounts due the contractor for work completed, but also wrongfully terminated the contract in Appeal No. 291, *supra*, the finding of the Board that there was no "connection between the failure to prosecute the work and financial difficulty arising out of Government action" is contrary to the evidence and is, therefore, clearly erroneous.

In its "Ruling on Motion for Reconsideration," the Board stated:

> Appellant affirmatively states that it was not prevented from performing because of any financial difficulties which were found to exist with respect to the appeal in Discount Company, AGBCA No. 291, 74-1 BCA ¶ 10,511, involving construction of the North Waldo Lake Campground. Although, the decision of the Board in this case (AGBCA No. 273) referred to those matters, the Board concluded that termination for default was warranted for other reasons. The Board specifically found that the Government was not responsible for failure of appellant to proceed diligently with prosecution of the Mona Campground and Lookout Boating Site contract.

The Board does not explain the "other reasons" for which it concluded that the termination for default was warranted in *this* case. The financial problems of the contractor appear to be the *only* reasons for the alleged lack of progress toward completion. Some equipment was still on the site at the time of termination and there is no evidence that the contractor had gone out of business. Neither is there any evidence that any subcontractor refused to proceed with work on the site.

A cursory review of the administrative record in this case indicates that, due to the co-pendency of the appeals with respect to termination of the Waldo Lake contract and the present (Mona Campground and Lookout Boating Site) contract, the Board's decision in the present case was based on facts which would not, under applicable rules of evidence, be admissible in the present case, alone. Thus, the Board's *decision* in *this* case is not supported by *evidence* which is properly admissible in *this* case.

Syllabus

In view of all of the foregoing, I believe that the termination was and should be denominated as termination for convenience of the Government and not as a termination for default.

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553 F.2d 647

CORNELIUS W. GILES, JR. v. THE UNITED STATES

[No. 450–75. Decided April 20, 1977]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

Civilian pay; dismissal; Internal Revenue Service employee.— Plaintiff, a former nonprobationary GS–11 revenue officer, whose duties were to secure payments and filings of tax returns by delinquent taxpayers, received a notice of a proposed adverse action removing him for failure to file or to file timely his own federal and state income tax returns for 1969, 1970 and 1971; he was dismissed effective July 13, 1973. Following a hearing, plaintiff's removal was sustained by the Civil Service Commission Federal Employee Appeals Authority and in turn by the Civil Service Commission Appeals Review Board. It is *held* (1) that the fact that plaintiff was not accorded a pretermination hearing does not constitute denial of due process since plaintiff was accorded hearings in the administrative review of his removal; (2) that the action taken against plaintiff is sustainable as a matter within the discretion of the Service, that there was substantial evidence for the action, and that the action was taken in good faith and with careful adherence to applicable statutes and regulations; and (3) that the administrative action did not sanction a penalty too harsh in relation to the offense which bore a reasonable relationship to the efficiency of the Service. Defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed.

Civilian pay; Court of Claims jurisdiction; administrative or executive decisions; review of by court.

[1] This court's review of adverse personnel actions is limited to ascertaining that the final administrative appellate decision was in conformance with the Constitution, statutes and regulations, was not arbitrary or capricious or taken in bad faith, and was supported by substantial evidence.

United States ⚖36

Syllabus

Civilian pay; presumptions; official actions of Government officials; presumption of regularity.

[2] In this court's review of adverse personnel actions, the Government enjoys the presumption that its officials make their decisions in good faith.

United States ⚖36

Constitutional law; due process of law - Fifth Amendment; adverse personnel action; hearing, right to.

[3] The Lloyd-LaFollette Act makes the according of a pretermination hearing to a nonprobationary federal employee only discretionary with the removing authority. Where plaintiff was accorded post-termination hearings in accordance with applicable appeal procedures, such hearings suffice for due process.

Constitutional Law ⚖318(2)
United States ⚖36

Civilian pay; adverse personnel action; efficiency of service, promotion of.

[4] Where an Internal Revenue Service official testified that plaintiff's conduct in not timely filing his own income tax returns, in view of plaintiff's assigned official duties, would have a deleterious effect upon the morale of other IRS personnel and upon the respect which other Government agencies and the public had for the Service, this is substantial evidence upon which the Civil Service Commission could reasonably conclude that considerations of the efficiency of the Service justified, if not mandated, plaintiff's dismissal.

Internal Revenue ⚖1221

Civilian pay; dismissal; charges and reasons for dismissal; penalty v. offense.

[5] This court will normally defer to the administrative judgment on appropriate corrective action for improper conduct of an employee unless the severity of the penalty appears totally unwarranted in light of such factors as the range of permissible punishment specified by statute or regulation, the disciplined party's job level and nature, his record of past performance, the connection between his job and the improper conduct charged, and the strength of the proof that the conduct occurred. In the circumstances here, the penalty of dismissal was not so harsh and unconscionably disproportionate to the offense that it amounted to an abuse of discretion. Plaintiff was required to hold himself open to audit like other taxpayers by timely filing his income tax returns pursuant to 26 U.S.C. § 6012(a).

Internal Revenue ⚖1221

Thomas Angelo for plaintiff. *Robert M. Tobias, attorney of record.*

Stephen G. Anderson, with whom was *Acting Assistant Attorney General Irving Jaffe,* for defendant.

Before NICHOLS, KUNZIG, and BENNETT, *Judges.*

BENNETT, *Judge,* delivered the opinion of the court:

This case has come before the court on the motions of the parties for summary judgment. It is another in the spate of claims arising from adverse actions by the Internal Revenue Service (IRS) against employees who have violated statutes, regulations, or the IRS rules of conduct which hold employees to exemplary standards in the conduct of the public business and in their personal affairs which reflect on that business.[1]

Plaintiff was formerly a nonprobationary GS–11 revenue officer stationed in Alabama. It was his job to secure payments and filings of returns by delinquent taxpayers. By letter dated May 22, 1973, plaintiff received a notice of a proposed adverse action removing him for his own failure to file or to file timely federal and state income tax returns for the years 1969 (5 months late), 1970 (11 months late), and 1971 (8 months late). No state return was filed for 1971. Plaintiff replied orally to the charges which he admitted, asserting that his conduct was excusable because of personal problems and civic responsibilities, and that, in any event, he was entitled to a refund on each late or omitted return. Plaintiff was removed effective July 13, 1973.

Plaintiff notified his agency that he wanted an arbitration hearing, as provided in the collective bargaining agreement under which he was employed. *Cf. Byrnes* v. *United States,* post at 675. Pursuant thereto, a hearing was held with plaintiff present and represented by counsel. The arbitrator found that plaintiff was guilty of the charges against him but that the penalty of removal was too harsh,

[1] *Byrnes* v. *United States, post* at 675; *Boylan* v. *United States* 211 Ct.Cl. 370 (1976); *Boyce* v. *United States* 211 Ct.Cl. 57, 543 F.2d 1290 (1976); *Pascal* v. *United States,* 211 Ct.Cl. 183, 543 F.2d 1284 (1976); *Hoover* v. *United States,* 206 Ct. Cl. 640, 513 F.2d 603 (1975); *Dargan* v. *United States,* 208 Ct. Cl. 993 (1975); *Wathen* v. *United States,* 208 Ct. Cl. 342, 527 F.2d 1191 (1975), *cert. denied,* 429 U.S. 821 (1976); *Grover* v. *United States,* 200 Ct. Cl. 337 (1973); *Birnholz* v. *United States,* 199 Ct. Cl. 532 (1972); *Ciambelli* v. *United States,* 198 Ct. Cl. 240 (1972); *Williams* v. *United States,* 193 Ct. Cl. 440, 434 F.2d 1346 (1970); *Finn* v. *United States,* 152 Ct. Cl. 1 (1961).

and recommended that it should be set aside and a formal reprimand substituted. The IRS rejected the arbitrator's opinion and affirmed the discharge.

Plaintiff appealed the IRS adverse action to the Civil Service Commission (CSC) and requested a hearing. A hearing was held on July 12, 1974, before the Federal Employee Appeals Authority (FEAA) in Birmingham. The FEAA found that the charges were sustained and unexcused. Plaintiff was so advised by letter dated September 12, 1974.

Plaintiff next appealed to the CSC Appeals Review Board (ARB). In an opinion dated March 31, 1975, the ARB rejected all of plaintiff's contentions and affirmed his removal. On December 24, 1975, plaintiff filed the present suit seeking back pay. His claim is now predicated on three principal allegations: (1) failure to afford him a pretermination hearing; (2) failure of IRS to show that his discharge was for such cause as would promote the efficiency of the service; (3) plaintiff was treated more harshly than other IRS personnel similarly situated. We will discuss these contentions in the order stated, although we find merit in none of them.

In the beginning, it must be noted that in considering these adverse personnel actions our review is limited to ascertaining that the final administrative appellate decision was in conformance with the Constitution, statutes, and regulations, was not arbitrary or capricious or taken in bad faith, and was supported by substantial evidence. *Urbina* v. *United States*, 209 Ct. Cl. 192, 530 F.2d 1387 (1976); *Crowley* v. *United States*, 208 Ct. Cl. 415, 441, 527 F.2d 1176, 1190 (1975); *Charley* v. *United States*, 208 Ct. Cl. 457, 464–65 (1975); *Boyle* v. *United States*, 207 Ct. Cl. 27, 34, 515 F.2d 1397, 1401 (1975). Further, the Government enjoys the presumption that its officials make their decisions in good faith. *Crowley* v. *United States*, *supra*, 208 Ct. Cl. at 442, 527 F.2d at 1191; *Charley* v. *United States*, *supra*; *Boyle* v. *United States*, *supra*.

Plaintiff's contention about defendant's failure to accord him a pretermination hearing raises the constitutional issue of due process in his removal procedures. The Lloyd-LaFollette Act, 5 U.S.C. § 7501(a) (1970), specifically makes

a pretermination hearing only discretionary with the removing authority. The Supreme Court considered a similar issue in *Arnett* v. *Kennedy*, 416 U.S. 134 (1974). The decision there was a plurality one, but it makes clear that a pretermination hearing was not necessary for agency action against a nonprobationary employee to pass muster under the due process clause of the fifth amendment. The justices gave different reasons for reaching the same conclusion squarely applicable to the facts of the instant case. In short, in administrative review of his removal, plaintiff was accorded hearings, and they suffice for due process. The cause for his removal was ascertained under applicable procedures of the statute and avoided any "stigma" which would otherwise result from an arbitrary, improper discharge. Plaintiff argues that his "liberty" interest is infringed because he is entitled to be free from the stigma of the dismissal itself, but *Arnett* disposes of this by showing that the post termination appeal procedures have vindicated plaintiff's right to protect whatever liberty or property interests he has in this situation. Cases relied upon by plaintiff, none of which involve federal employees like plaintiff whose rights relate to the Lloyd-LaFollette Act, are deemed not to be in point.

Plaintiff next attacks the ARB decision as lacking in supporting evidence. He says defendant has failed to prove that his removal, for admitted failure to file tax returns, would "promote the efficiency of the service." 5 U.S.C. § 7501(a) (1970). Further, plaintiff says that, while in other cases the premise that willful, flagrant violation of tax laws by IRS officers charged with enforcing those laws may have a rational connection to their continued employment and to the effectiveness of a voluntary compliance system, it is not true here. Plaintiff's argument is that IRS permits other taxpayers to do without penalty what plaintiff did, to wit: fail to file timely where no tax is due or a refund is due. It is true that section 5(11)31.2(6) of the IRS manual allows a revenue officer to close a delinquent taxpayer's case in such circumstances. However, the revenue code makes it plain that citizens "shall" file their returns. 26 U.S.C. § 6012(a) (1970). This is elementary under a voluntary reporting system. The accounting and auditing

procedures under the system flow from it. Where plaintiff's argument breaks down is in assuming that he is above participating in this system. Yet, how must it appear to plaintiff's fellow workers, to revenue officials of his state, and to other members of the taxpaying public who know of it, that an agent of IRS evaded compliance with so elementary, but fundamental, a requirement of the income tax system? The IRS collection division chief testified that conduct such as plaintiff's would have a deleterious effect upon the morale of other IRS personnel and upon the respect which other Government agencies and the public had for IRS. We conclude that this is substantial evidence upon which the ARB could reasonably conclude that considerations of the efficiency of the service justified, if not mandated, plaintiff's discharge. As we said in *Birnholz* v. *United States*, 199 Ct. Cl. 532, 537 (1972):

> The IRS is rightly concerned with its image of honesty and integrity. Members of the public, who must turn square corners in tax matters, demand no less of revenue officials. * * *.

Nor is plaintiff excused by the procedure contained in the IRS manual, for that simply permits a revenue officer reviewing a taxpayer's account to dispense, in his discretion, with the formal disclosure once he is satisfied that he knows the taxpayer's financial picture and that no tax is owed beyond any already paid or withheld. Plaintiff cannot be considered an auditor of his own account, possessed with a dispensing power, but rather must hold himself open to audit like all other taxpayers by timely filing his returns, as the law requires. The thinking of plaintiff in this matter, carried to its logical extreme, would be for IRS to assume that the only people who fail to file returns are those who owe no tax. This, of course, is wishful thinking. It is no small burden for IRS to have to make investigations to ferret out the nonpayers. To the extent that taxpayers honestly file, and most do, the need for investigations is minimized and the efficiency of the Service is promoted. If, on the other hand, taxpayers are encouraged to believe they can unilaterally determine whether or not to file when their incomes are within the range which requires filing, the need for investigations increases and the

efficiency of the Service is impaired. Plaintiff's example undercuts the Service's efforts to encourage voluntary compliance and, if condoned, could impair the credibility of IRS with tax officers and the public generally.

We conclude, therefore, that the action taken against plaintiff is sustainable as a matter within the discretion of IRS, that there was substantial evidence for the action it took, and that the action was taken in good faith and with careful adherence to applicable statutes and regulations. *Wathen* v. *United States*, 208 Ct. Cl. 342, 527 F.2d 1191 (1975), *cert. denied*, 429 U.S. 821 (1976); *Schlegel* v. *United States*, 189 Ct. Cl. 30, 40, 416 F.2d 1372, 1377–378 (1969), *cert. denied*, 397 U.S. 1039 (1970). The present case is very similar to *Dargan* v. *United States*, 208 Ct. Cl. 993 (1975), which also involved the failure of an IRS employee to file his returns timely, among other offenses, and where removal was upheld.

Finally, plaintiff complains that the ARB ruling sanctioned a penalty too harsh in relation to the misconduct involved. The court will normally defer to the administrative judgment on appropriate corrective action unless its severity appears totally unwarranted in light of such factors as the range of permissible punishment specified by statute or regulation, the disciplined party's job level and nature, his record of past performance, the connection between his job and the improper conduct charged, and the strength of the proof that the conduct occurred. *Boyce* v. *United States*, 211 Ct. Cl. 57, 543 F.2d 1290 (1976); *Rifkin* v. *United States*, 209 Ct. Cl. 566 (1976), *cert. denied*, 429 U.S. 1098 (1977); *Power* v. *United States*, 209 Ct. Cl. 126, 531 F.2d 505 (1976).

It is true that plaintiff served IRS for over 20 years, that he did not owe a tax, and that he had serious personal problems and responsibilities. However, plaintiff did not bother to request an extension of time for filing his returns, even though such extensions may be readily obtained for good cause. Further, his job as a GS–11, step 6, revenue officer was fairly high placed, required him to deal directly with the taxpaying public as an IRS representative, and engaged him in the task of extracting from delinquent taxpayers not only monies due but their returns as well.

Syllabus

There was no abuse of discretion or bad faith in defendant's concluding, under all the circumstances, that the offense bore a reasonable relationship to the efficiency of the Service. The case is more like *Byrnes* v. *United States, supra,* where dismissal was upheld, than like *Boyce* v. *United States, supra,* where it was overturned. *Cf. Rifkin* v. *United States, supra.* Further, plaintiff has not contested that the alleged conduct occurred, the egregious nature of which plainly sets the case apart from *Power* v. *United States, supra.* Finally, plaintiff has failed to establish that the ARB erred in discounting his assertion that he was accorded disparate treatment, being given a harsher penalty than others in similar circumstances. Accordingly, we cannot say that plaintiff's penalty was "so harsh and unconscionably disproportionate to the offense that it amounts to an abuse of discretion." *Power* v. *United States, supra,* 209 Ct. Cl. at 130, 531 F.2d at 507. There is no call for us to upset the ARB-approved penalty determination on such a record as this one.

Defendant's motion for summary judgment is granted. Plaintiff's cross-motion for summary judgment is denied. The petition is dismissed.

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562 F.2d 1197

LT. COL. JOSEPH B. BERGEN v. THE UNITED STATES

[No. 356–74. Decided April 20, 1977. Plaintiff's motion for rehearing and relief from judgment denied May 27, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Military pay; "automatic" promotion; Air Force Reserve Officers regulations.—Plaintiff, a former Air Force Lt. Colonel (Reserves), challenges as arbitrary and capricious the action by the Air Force Board for Correction of Military Records in refusing to accelerate the date of his promotion to Lt. Colonel in order to avoid his automatic retirement under 10 U.S.C. § 8848 for failure to make full Colonel within the requisite time period. Plaintiff contends that but for delay in notifying him that he was on the Lt. Colonel promotion list, he would have been promoted from Major to Lt. Colonel before July 1, 1969, thus

avoiding said automatic retirement. He also contends that promotion to Lt. Colonel was "automatic" under 10 U.S.C. § 8366. It is *held* that plaintiff has not shown (1) that he meets the governing requirements set forth in Air Force Manual 35–3, ch. 23, for an out-of-sequence promotion to fill a "unit and mobilization augmentation grade vacancy"; and (2) that the Board, in denying his application for change in the date of his promotion to Lt. Colonel, acted arbitrarily, capriciously, or against the substantial weight of the evidence. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Military pay; promotions; Air Force Reserve officers.

[1] 10 U.S.C. § 8366(d)(1970), in providing that certain Reserve officers (here Major) whose names are on a recommended list *may* be promoted at any time to fill a vacancy, is not self-executing; it is effectuated only by its implementing regulations. "May" unlike "shall" is not a word of command, but of permission.

Armed Services ⚖7

Military pay; promotions; eligibility for promotion; automatic promotion; Air Force Reserve officers.

[2] To achieve an "automatic" promotion in the Air Force Reserves from Major to Lt. Colonel pursuant to AFM 35–3, ch. 23–7(b), the officer's name must be on a recommended list for promotion to Lt. Colonel, the officer must be filling the vacancy slotted for the higher rank, he must be recommended for promotion to Lt. Colonel by the commander of the unit having the vacancy, and all of these requirements must be met at least 30 days prior to the meeting of the appropriate selection board.

Armed Services ⚖7

Military pay; promotions; courts, jurisdiction.

[3] Courts generally are not in the promotion business.

Armed Services ⚖7

Joseph B. Bergen, pro se. Jack E. Miller, of counsel.

John W. Showalter, with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Before SKELTON, KASHIWA, and KUNZIG, *Judges.*

KUNZIG, *Judge,* delivered the opinion of the court:

This military pay case comes before the court on cross-motions for summary judgment. Plaintiff (a former Air Force Reserve Lieutenant Colonel retired from the Judge Advocate General's Department) argues that the Air Force Board for the Correction of Military Records (AFBCMR) improperly denied his claim that he was entitled to an

"automatic" out of sequence promotion to Lieutenant Colonel. Defendant contends that the AFBCMR acted neither arbitrarily nor capriciously nor against the substantial weight of the evidence in refusing to grant plaintiff's application and should, therefore, be affirmed.

Plaintiff's claim must fail. Although the decision is not an easy one, and was reached only after supplemental briefing was requested from both parties, no other result is possible. Plaintiff has not shown that he meets the governing requirements set forth in Air Force Manual (AFM) 35–3, Chapter 23[1] (hereinafter Chapter 23) for an out of sequence promotion to fill a "unit and mobilization augmentation grade vacancy."

Plaintiff is seeking to have his promotion to Lieutenant Colonel moved from April 4, 1970 to some time prior to July 1, 1969. Unless plaintiff was promoted to Lieutenant Colonel before July 1, 1969, he could not be considered (and possibly promoted) by a Colonel Selection Board which met on July 10, 1972, due to plaintiff's insufficient time in rank as Lieutenant Colonel. 10 U.S.C. § 8363(a) (1970); AFM 35–3, Ch. 21–3(c). The promotion to Colonel in July 1972 was crucial for plaintiff, for unless promoted by September 1972, he became subject to automatic retirement under 10 U.S.C. § 8848 (1970) (28 years of service without selection for rank of Colonel). Plaintiff was in fact automatically retired for this reason.

Basically, plaintiff claims that but for the delay in notifying him of his placement on a recommended list for promotion to Lieutenant Colonel, he would have been promoted to Lieutenant Colonel before July 1, 1969, thus avoiding his ultimate automatic retirement for failure to make full Colonel within the requisite time period. Plaintiff relies principally on 10 U.S.C. § 8366(d) (1970), and supporting affidavits of persons involved in the promotion process. The Government, too, relies on 10

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[1] Prior to June 25, 1969, "Promotion to USAFR to Fill Unit and Mobilization Augmentation Grade Vacancies" was found at AFM 35–3, Chapters 60–62. The regulations were amended effective June 25, 1969. As no difference (material to this case) is found between the pre- and post-June 25, 1969 regulations, all references will be to the post-June 25, 1969 version.

U.S.C. § 8366(d) (1970), but asserts that the application of this section can only be determined through an examination of its implementing regulations found in the Air Force Manual, Chapter 23. Plaintiff, in reply, argues that Chapter 23 does not apply to him, but that if it does, he has met its requirements.

We conclude that the dispositive issue in this case is whether plaintiff met the requirements of Chapter 23 for an "automatic," out of sequence promotion, so that he should have been promoted prior to July 1, 1969.[2] We reach this conclusion for two reasons. First, the language of 10 U.S.C. § 8366(d) (1970), on which plaintiff relies, is not self-executing;[3] it is effectuated only by its implementing regulations (inartfully drawn though they may be). Second, plaintiff's affiants, while perhaps evidencing views somewhat divergent from the regulations, do not control the regulations, but are governed by them.

Chapter 23 delineates two methods by which plaintiff could achieve an "automatic," out of sequence promotion. Although plaintiff argues only the first, in fairness to this *pro se* plaintiff, we shall analyze each method in turn.

To qualify for promotion under method A, plaintiff must meet three requirements at issue here:

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[2] As discussed *supra*, July 1, 1969 is plaintiff's "magic day." Unless the court finds he should have been promoted to Lieutenant Colonel before this day, his further claim for promotion to Colonel (assuming the court would order promotion, *but see Doggett* v. *United States*, 207 Ct.Cl. 478,482 (1975)) fails, as plaintiff would not have spent three years as a Lieutenant Colonel prior to the Colonel Selection Board's July 1, 1972 cut-off date. 10 U.S.C. § 8363(a) (1970); AFM 35–3, Ch. 21–3(c). Because July 1, 1969 is plaintiff's "magic day," it is not necessary to discuss plaintiff's possible promotion to Lieutenant Colonel on any date subsequent to June 30, 1969. (April 4, 1970 was the actual date of plaintiff's promotion to Lieutenant Colonel.)

[3] 10 U.S.C. § 8366(d) (1970) states, in pertinent part:

> An officer whose reserve grade is . . . major and whose name is on a recommended list *may* be promoted at any time to fill a vacancy . . . (emphasis supplied)

Plaintiff argues that, in this section, "may" equals "shall" with the result that any Major on a recommended list who is filling a vacancy is, without more, to be "automatically" promoted. Not only does such a reading do violence to the plain meaning of the section, *Selman* v. *United States*, 204 Ct.Cl. 675,680, 498 F.2d 1354,1356 (1974), but it also would destroy an orderly promotion process. Contrary to plaintiff's position, when something "may" be done, it invites regulations to fill out the conditions by which the act is to be done. "May," unlike "shall," is not a word of command, but of permission.

(1) His name must be on a recommended list for promotion to Lieutenant Colonel;
(2) He must be filling the vacancy slotted for the higher rank; and
(3) He must also be recommended for promotion to Lieutenant Colonel by the commander of the unit having the vacancy.

All of these requirements must be met at least *thirty days* prior to the meeting of the appropriate selection board. If all the requirements are satisfied prior to the thirty-day cut-off date, then the officer is "automatically" promoted without having to go before the selection board, and the selection is effective one day before those of officers promoted by the selection board. AFM 35–3, Ch. 23–7(b).

Applying the facts of the instant case to the requirements of method A, we find that plaintiff satisfied the conditions, *but not by the cut-off date.* In plaintiff's case, the cut-off date was May 20, 1969, thirty days before the meeting date of the June 19, 1969 selection board.[4] Promotions made by the June 19 selection board were effective June 30, 1969. Plaintiff, if he had satisfied the necessary requirements by May 20, would have been promoted effective one day earlier, or June 29, 1969. AFM 35–3, Ch. 23–7(b).

Examining the three requirements in reverse order, the facts show that plaintiff was not recommended for promotion by the commander of the unit having the vacancy until December 1969. Even though the unit commander stated by affidavit that he would have recommended plaintiff in June 1969, a recommendation in June would still not salvage plaintiff's case. Under no construction of the facts could plaintiff have been recommended by May 20, 1969.

Turning to the second requirement, the facts again illustrate that plaintiff was too late. He did not fill a vacancy slotted for a Lieutenant Colonel until August 5, 1969. The fact that the position was available in June and that plaintiff might have received assignment to it in June

[4] The Government suggests that May 19 is the thirty-day cut-off date. Our calculation indicates May 20. However, the difference between defendant's date and our own is not material. As defendant does not explain its method of calculation, we use our own.

does not change our result. Nothing in the record shows that the vacancy was available in May, or, even if it was, that plaintiff would have known about it or would have been assigned to it by May 20.

The first requirement is that plaintiff had to be on a recommended list for promotion to Lieutenant Colonel by the May 20, 1969 cut-off date. Whether plaintiff met this requirement gives us some difficulty. Plaintiff was placed on a recommended list on February 3, 1969. However, this list, which contained instructions for notification of the named officers, was not released until June 2, 1969. It appears then that the operative date plaintiff was placed on the recommended list was June 2. At any time from February 3 to June 2, plaintiff's name possibly could have been removed by the Secretary of the Air Force.

We note that plaintiff did not meet either the second or third requirements by the proper date. This alone defeats plaintiff's claim for promotion. It is, therefore, unnecessary for us fully to analyze the first requirement—whether plaintiff was on the recommended list by the cut-off date. We hold plaintiff failed timely to meet requirements (2) and (3). Taking into consideration the incomplete briefing on requirement (1), we decline to reach it.

At this juncture, then, we have seen that plaintiff was three and six months late in satisfying necessary requirements of method A to reach "automatic" promotion. Although plaintiff fails to argue the second possible method (method B), we nevertheless now examine the requirements to see if, by any possible interpretation, plaintiff somehow qualifies.

This alternative method states three pertinent requirements that must be met by the May 20, 1969 cut-off date:

(1) Plaintiff's name must be on a recommended list for promotion to Lieutenant Colonel;
(2) If not occupying the vacancy slotted for the higher rank, he must either be
"assigned to the same Reserve section as the unit having the vacancy. (If the vacancy is in a unit, the officer must be assigned to that organization. If a mobilization augmentation position vacancy . . . exists, he must be assigned to the MAJCOM having the vacancy);" or

"[a]n officer whose application for assignment to a unit having the vacancy has been approved but whose assignment has not yet been effected." AFM Chapter 23–2(a)(2) & (3).

(3) He must have been recommended for promotion to Lieutenant Colonel and to the slot by the commander of the unit having the vacancy.

The requirements are slightly different from those discussed in method A, *supra*. Yet plaintiff fails to meet these requirements for "automatic" promotion for the same reason he failed to meet the requirements of method A: He was too late. He met neither the second nor the third requirement by May 20, 1969. He was assigned to the unit having the Lieutenant Colonel vacancy at the same time that he was assigned to the vacancy itself—August 1969, almost three months after the cut-off date. He was not recommended for promotion to Lieutenant Colonel until December 1969, some six months after May 20, 1969.

Plaintiff, however, argues that but for the delay from June 2, 1969 to July 7, 1969 in his being notified that he was on the recommended list, he "would have met the requirements for 'automatic' promotion." This argument lacks viability. That plaintiff could somehow satisfy two requirements by May 20, 1969 when, by his own admission, he had no reason to try to meet these requirements until after June 2, 1969 (three weeks subsequent to May 20, 1969), illustrates the lack of merit in plaintiff's claim. We are left with a piling of inference upon inference, devoid of factual support. Even if this court were in the promotion business, which it has repeatedly said it is not,[5] we would be hard-pressed to find a solid link in plaintiff's chain of "ifs."[6] One clear fact remains: He did not meet the appropriate requirements in time.

Simply put, plaintiff has not shown that the AFBCMR, in denying his application for change in the date of his promotion to Lieutenant Colonel, acted arbitrarily, capri-

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[5] *See, e.g., Yee* v. *United States*, 206 Ct.Cl. 388,399, 512 F.2d 1383,1388 (1975); *Brenner* v. *United States*, 202 Ct.Cl. 678 (1973), *cert. denied*, 419 U.S. 831 (1974).

[6] We note that even if plaintiff had been promoted to Lieutenant Colonel in time to be considered by the July 1972 Colonel Selection Board, we have no way of knowing (and, we might add, neither does plaintiff) if plaintiff would have been placed on the recommended for promotion list by the board and thereby spared automatic retirement.

ciously, or against the substantial weight of the evidence. *Compare Doggett* v. *United States*, 207 Ct.Cl. 478,483 (1975); *with Yee* v. *United States*, 206 Ct.Cl. 388,397, 512 F.2d 1383,1387 (1975); *Skaradowski* v. *United States*, 200 Ct.Cl. 488, 471 F.2d 627 (1973); *Duhon* v. *United States*, 198 Ct.Cl. 564, 461 F.2d 1278 (1972).

In summary, in order for plaintiff to qualify for so-called "automatic" promotion, he had to meet the requirements of Chapter 23. Even with a pyramiding of inference upon inference which sorely taxes the imagination, he failed.

Accordingly, upon consideration of the briefs (original and supplemental) and record, and after hearing oral argument, plaintiff's motion for summary judgment is denied, defendant's motion for summary judgment is granted, and the petition is dismissed.

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553 F.2d 644

ARISTAR, INC. v. THE UNITED STATES

[No. 292–75. Decided April 20, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Taxes; income tax; adjustments; allocation of income and deductions among taxpayers.—Plaintiff is a holding company, not actively engaged in business, with about 450 subsidiaries whose operations consisted primarily of making installment loans to individual borrowers. During 1964, 1965 and 1966, the tax years in dispute, plaintiff borrowed funds, at interest rates of 5.3% to 5.5%, which it loaned its subsidiaries, charging them an effective overall rate of between 9.1% and 9.3%. Each subsidiary filed a separate income tax return, deducting the interest paid to plaintiff. If a subsidiary had sufficient net earnings for the current year plaintiff charged an interest rate of 10%. Under the credit agreement lower percentages or no percentages of interest were paid depending upon the amounts of insufficiencies or losses in earnings. The Commissioner allocated additional interest income to plaintiff under Sec. 482 of the Code from those subsidiaries paying no interest or interest less than 4%, pursuant to the arm's-length interest rate of Treas. Reg. § 1.482–2(a)(2)(iii)(B). The Commissioner also made an adjustment to each subsidiary which increased its interest deduction by the amount included in plaintiff's interest income, resulting in additional taxes for plaintiff. Plaintiff filed the present suit upon disallowance of its claims for refund. In concurring with the conclusion in *Liberty Loan Co.* v. *United States*, 498 F.2d 225 (8th Cir. 1974), *cert. denied*, 419 U.S. 1089, the court *holds* that the Commissioner properly

exercised his discretion under Sec. 482 and implementing regulations by treating each individual loan to a subsidiary as a separate transaction, which for adjustment purposes had to be measured separately against the arm's-length standard of the statute and regulations. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

Taxes; income tax; adjustments; allocation of income and deductions among taxpayers.

[1] Where parent-taxpayer, a holding company with numerous subsidiaries engaged in the consumer finance business, borrowed, at rates of 5.3% to 5.5%, large sums of money which it then loaned to its subsidiaries at effective overall rates of between 9.1% and 9.3%, the solvent subsidiaries paying 10% interest and the others paying substantially less interest or no interest depending upon their losses, with respect to those subsidiaries paying taxpayer less than 4% or no interest, the Commissioner acted within his discretion under the arm's-length standard of Sec. 482 and implementing regulations in allocating to taxpayer interest income of 5%, treating each individual loan as a separate transaction, to bring the 4% or less interest loans into conformity with the statute. This treatment conforms with the purpose of the grant of discretion to the Commissioner to restructure, for tax purposes, transactions between one controlled taxpayer and another so as to place the controlled taxpayers on a tax parity with uncontrolled taxpayers entering into similar transactions with unrelated parties.

Internal Revenue ⊂⇒1387

Richard J. Hiegel, attorney of record for plaintiff. *Alvin J. Goldman*, of counsel.

Allan C. Lewis, with whom was *Acting Assistant Attorney General Myron C. Baum*, for defendant. *Theodore D. Peyser* and *Robert S. Watkins*, of counsel.

Before COWEN, *Senior Judge*, DAVIS, and SKELTON, *Judges*.

SKELTON, *Judge*, delivered the opinion of the court:

Plaintiff (taxpayer) in this case is a holding company with approximately 450 subsidiaries engaged in the consumer finance business in some 30 states. Plaintiff, itself, is not actively engaged in business and during the fiscal years in question (1964, 1965, and 1966) had only a minor amount of assets besides its advances to and equity investments in its subsidiaries. The consumer finance operations of the subsidiaries consisted primarily of making installment

loans to individual borrowers in amounts ranging from $300 to $2,500.

Plaintiff operated by borrowing money and relending it to its subsidiaries. The subsidiaries were not acceptable credit risks on an individual basis; however, taxpayer was an acceptable risk and borrowed from various sources including banks. These borrowed funds were then loaned to the individual subsidiaries at a higher rate of interest under a credit agreement in which each subsidiary promised to pay its outstanding debt as of the date of execution and any sums borrowed from taxpayer in the future. Each subsidiary executed and carried on its balance sheet a note payable to its parent. In addition, each subsidiary filed a separate income tax return, and deducted thereon the interest paid to the parent corporation.

In relending funds to its subsidiaries, taxpayer followed a formula which charged interest on a ten percent if earned basis. If a subsidiary had sufficient net earnings for the current year, it paid interest at the ten percent rate. If a subsidiary had an accumulated deficit and a current loss (which reflected an interest expense of ten percent of its average daily balance of indebtedness), it paid no interest if the current loss was in excess of the ten percent interest expense figure. (In other words, a subsidiary's interest payments were reduced according to its operating losses.) However, if the ten percent interest figure was greater than the current loss, the subsidiary paid interest equal to the difference between the ten percent interest figure and the current loss. The adjustment in this latter situation could reduce the loss to zero. For example, if a subsidiary had income of $10 and expenses of $18 including $6 of interest, its current loss would be $8 ($10–$18) and it would pay no interest. For tax purposes, the subsidiary would report $10 of income and $12 of deductions (because the $6 of interest was not paid to the parent), or a loss of $2 for the year. If a subsidiary had income of $10 and expenses of $12, including $6 of interest, its current loss would be $2 ($10–$12), and it would pay interest of $4 ($6–$2), the difference between the ten percent interest figure and the current loss. Thus, the subsidiary would report for tax purposes the $10 of income and $10 of deductions (which

includes $4 of interest) or a zero gain for the year. During the years in dispute, plaintiff was able to obtain an interest rate of 5.3 percent to 5.5 percent on its commercial borrowing, and charged an effective overall rate to its subsidiaries of between 9.1 percent and 9.3 percent.

On audit, the Commissioner of Internal Revenue made no adjustment to the taxpayer's interest income with respect to those subsidiaries which paid four percent or more interest. However, additional interest income was allocated to taxpayer under Section 482 of the Internal Revenue Code and the regulations thereunder from those subsidiaries which paid no interest or interest less than four percent. The additional interest income from each subsidiary was the difference between five percent interest and the amount of interest actually paid by the subsidiary. This was in accordance with regulations § 1.482–2(a)(2)(iii)(B), which provides that if a creditor "was not regularly engaged in the business of making loans or advances * * * to unrelated parties, the arm's length rate of interest * * * shall be * * * five per cent per annum simple interest if no interest was charged or if the rate of interest charged was less than 4, or in excess of 6, per cent per annum simple interest." The implications of the term "arm's length interest" will be discussed below.

> Internal Revenue Code of 1954 (26 U.S.C. § 482):
> § 482. Allocation of income and deductions among taxpayers.
>
> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

The Commissioner also made a correlative adjustment to each subsidiary which increased its interest deduction by the amount included in the parent's interest income. The

additional interest income resulted in additional tax for the fiscal years 1964, 1965, and 1966 in the approximate amounts of $55,134.82, $66,319.41, and $128,435.51, respectively. These additional amounts were not paid in full by the taxpayer because the Internal Revenue Service made other favorable adjustments which decreased the amount of tax owed by the taxpayer. Plaintiff's claims for refund were disallowed by the Internal Revenue Service's Jacksonville District Office on August 13, 1973, and plaintiff filed this suit on August 11, 1975, seeking total refunds of $215,122.80. Both parties move for summary judgment.

The taxpayer's principal argument in support of its motion for summary judgment is that the Commissioner erred in considering the various loans individually in determining whether a Section 482 adjustment was appropriate. The taxpayer argues that the Commissioner should have considered the total interest income received by it from all its loan transactions as a whole, and that, so considered, the loan arrangement produced interest income equivalent to an arm's-length rate of interest. On the other hand, it is the government's contention that the Commissioner properly exercised his discretion under Section 482 and regulations promulgated thereunder by treating each individual loan to a subsidiary as a separate transaction, which for adjustment purposes had to be measured separately against the arm's-length standard of the statute and implementing regulations. The government's position finds direct support in *Liberty Loan Corp.* v. *United States*, 498 F.2d 225 (8th Cir. 1974), *cert. denied*, 419 U.S. 1089. Based on a thorough review of this case and the authorities cited therein, we concur with the view of the Eighth Circuit and accordingly enter judgment in favor of the government.

The express language of Section 482 is simple and clearly indicative of its purpose. Where two or more entities are owned or controlled by the same interest, the Commissioner is granted discretion to allocate gross income between or among them only if he first "*determines* that such * * * allocation is necessary in order to prevent evasion of taxes or *clearly to reflect income*" of the commonly controlled entity. (Emphasis supplied.) The

purpose of the grant of discretion is to curb income distortion that arises when income, deductions, credits, etc., are arbitrarily shifted between or among commonly controlled entities. The purpose is achieved by granting the Commissioner the discretion to restructure, for tax purposes, transactions between one controlled taxpayer and another so as to place the controlled taxpayers on a tax parity with uncontrolled taxpayers entering into similar transactions with unrelated parties. The standard for tax parity and thus the standard for clear reflection of income, is the "arm's-length" standard. Regulations § 1.482–2(a)(1) reads:

> Where one member of a group of controlled entities makes a loan or advance directly or indirectly to, or otherwise becomes a creditor of, another member of such group, and charges no interest, or charges interest at a rate which is not equal to an arm's length rate as defined in subparagraph (2) of this paragraph, the District Director may make appropriate allocations to reflect an arm's length interest rate for the use of such loan or advance.

Regulations § 1.482–2(a)(2) provides that the arm's-length interest rate shall be the rate "charged in independent transactions with or between unrelated parties under similar circumstances."

The taxpayer in this case was able to reduce its interest income and the total tax burden of the group by charging its subsidiaries which could not fully utilize the interest deductions less than the arm's-length rate of interest. It is this type of arbitrary shifting of deductions in order to reduce taxes of the controlled group that Congress sought to combat when it enacted Section 482.

The statute and regulations, together with the precedent of *Liberty Loan Corp.* v. *United States, supra,* provide sufficient basis for our holding for the government. Plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted, and plaintiff's petition is dismissed.

Syllabus

553 F.2d 637

ESTATE OF MARIAN B. FARREL v. THE UNITED STATES

[No. 293–75. Decided April 20, 1977]

OPINION

Taxes; estate tax; inclusions in gross estate; revocable transfer v. transfer with retained life estate.—This case is before the court on a stipulation of facts. Decedent-settlor transferred certain securities to an irrevocable trust, her grandchildren being named beneficiaries and the time of division of the corpus being provided for. The instrument named and called for two trustees; they had the discretionary power to make payments to or for the benefit of the specified beneficiaries. The settlor could appoint a successor trustee if a vacancy occurred through death, resignation or removal by a proper court for cause, and although neither the trust nor Connecticut law permitted the settlor to remove a trustee, the settlor was not prevented from appointing herself as trustee in event of a vacancy under the prescribed conditions. Before her death the settlor made two successor-trustee appointments. The settlor died in 1969 and, after the filing of a federal estate tax return which did not include the trust property in the gross estate, the IRS assessed a deficiency on the ground that the trust property should have been included in the gross estate under Sec. 2036(a)(2) of the 1954 Code. Plaintiff paid the deficiency and assessed interest, and in this suit seeks refund thereof, together with statutory interest. Plaintiff contends that the settled understanding that Sec. 2038 does not cover a power or right subject to a conditional event which has not occurred prior to and does not exist at decedent's death applies also to Sec. 2036(a). Plaintiff also asserts that Treas. Reg. 20.2036–1(b)(3) is invalid. In view of the critical differences between the two sections, it is *held* that Sec. 2036(a) as it now stands cannot be equated with Sec. 2038; that the regulations governing the two sections take diametrically opposed positions on the issue of contingent rights and powers of the kind involved here; that decedent's contingent right to designate the persons who shall possess or enjoy the property or the income therefrom requires inclusion of the corpus of the trust in her gross estate under Sec. 2036(a); and that Treas. Reg. 20.2036–1(b)(3) is valid. Plaintiff is not entitled to recover and the petition is dismissed.

Taxes; estate tax; gross estate, inclusions in; revocable transfers v. transfers with retained life estate.

[1] While Sec. 2038 of the Internal Revenue Code of 1954 excludes from decedent's gross estate those contingent rights and powers (beyond decedent's control) which are not exercisable at decedent's death because the designated contingency does not exist at that time, Sec. 2036(a) looks forward from the time decedent made the transfer to

determine whether he has retained any of the specified rights "for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death." Sec. 2036(a) can be thought to represent Congress' reasonable overall purpose to gather into the estate tax all property over which the decedent has at death some significant, though contingent, power to choose those who shall have possession or enjoyment of the property or the income therefrom. Since the subject decedent's contingent right to make herself a trustee in event of a vacancy was a legally enforceable right and was foreseeable when the trust was created, the trust property could be includable in decedent's gross estate pursuant to Sec. 2036(a)(2).

Internal Revenue ⚖1001

Taxes; Treasury Regulations; gross estate; transfers with retained life estate.

[2] Since neither the text nor the purpose of Sec. 2036 demands the same treatment as Sec. 2038, and since judicial interpretation of Sec. 2036's predecessor was neither so strong nor so encrusted that Congress may be thought to have embodied it in Sec. 2036 when it adopted the 1954 Code, the current implementing regulation § 20.2036–1(b)(3), although not adopted contemporaneously with the adoption of Sec. 2036's predecessor, is valid and represents a reasonable reading of the text and objectives of Sec. 2036.

Internal Revenue ⚖158

Stephen Gurko, attorney of record, for plaintiff.

C. Patrick Derdenger, with whom was *Acting Assistant Attorney General Myron C. Baum,* for defendant. *Theodore D. Peyser, Donald H. Olson,* and *Allan C. Lewis,* of counsel.

Before DAVIS, KASHIWA and KUNZIG, *Judges.*

DAVIS, *Judge,* delivered the opinion of the court:

The stipulated facts in this tax refund suit thrust upon us a narrow but knotty issue of estate tax law under Section 2036(a)(2) of the Internal Revenue Code of 1954.[1] In 1961 Marian B. Farrel established an irrevocable trust with a corpus of various securities and her grandchildren as beneficiaries. Two individuals were named as trustees. They were given discretionary power to pay or apply all or part of the net income or principal to or for the benefit of any one or more of the beneficiaries (and their issue). The instrument also provided for a "time of division" when the

[1] This opinion contains the necessary facts and we enter no separate findings.

corpus was to be divided into various portions, each of which (according to specified circumstances) was either to be paid over immediately to a specified beneficiary, or held in a new trust with the trustees having discretionary power to make payments to or for the benefit of specified beneficiaries until a later time when required payments were to be made. No provision was made in the trust for any distribution to Mrs. Farrel in any circumstances.

The trust called for two trustees at all times, and provided for Mrs. Farrel to appoint a successor trustee if a vacancy occurred in that position through death, resignation or removal by a proper court for cause. However, neither the instrument nor Connecticut law (which governed the trust) permitted Mrs. Farrel to remove a trustee and thereby create a vacancy. The trust was silent as to whether Mrs. Farrel could appoint herself as a successor trustee in the event of a vacancy, but neither the trust instrument nor Connecticut law would have prevented her from doing so.

Two vacancies occurred in the office of trustee during Mrs. Farrel's life. In 1964 a named trustee died and Mrs. Farrel appointed a third person as successor trustee. In 1965 that successor trustee resigned and Mrs. Farrel, as settlor, appointed another individual to succeed him.

Mrs. Farrel died in October 1969. Her estate, plaintiff here, filed in 1971 a federal estate tax return which did not include the trust property in the gross estate, and paid the tax shown on the return.[2] In 1973 the Internal Revenue Service assessed a deficiency on the ground that the trust property should have been included in the gross estate under Section 2036(a)(2) of the 1954 Code.[3] Plaintiff paid

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[2] Mrs. Farrel and her husband reported the transfers to the trust as a gift in 1961 and paid the federal gift taxes.

[3] Section 2036(a) provides:

(a) [as amended by Sec. 18(a), Revenue Act of 1962, P.L. 87–834, 76 Stat. 960] *General Rule.*—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

the deficiency, filed a timely refund claim, and after the appropriate waiting period instituted the present refund suit.

Both parties agree that (a) the trustees had "the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom" within the meaning of Section 2036(a)(2);[4] (b) Mrs. Farrel, the decedent-settlor, could lawfully designate herself (under the trust and Connecticut law) as successor trustee if a vacancy occurred during her life; (c) the occurrence of a vacancy in the office of trustee was a condition which Mrs. Farrel could not create and which was beyond her control; and (d) Mrs. Farrel had the opportunity, before her 1969 death, to appoint a successor trustee only during the two periods in 1964 and 1965 mentioned above. The legal conflict is whether the right of the trustees (as to who should enjoy or possess the property or income) should in these circumstances be attributed to the decedent under § 2036(a) for any of the three periods designated in that statutory provision—her life; any period not ascertainable without reference to her death; any period which does not in fact end before her death. The Government's answer is yes and the plaintiff of course says no.

Only Section 2036(a) is now before us but, since taxpayer's presentation emphasizes a comparison of that provision with Section 2038 (a cognate but separate part of the estate tax), it is important to set out, at the beginning, the relevant aspects of the latter, as we do in the margin.[5]

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(1) the possession or enjoyment of, or the right to the income from, the property, or

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

[4] Taxpayer does not argue that under the trust this right of the trustees was measured by objective or external standards.

[5] (a) [as amended by Sec. 18(a), Revenue Act of 1962] *In General.*—The value of the gross estate shall include the value of all property—

(1) *Transfers after June 22, 1936.*—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the

Plaintiff's primary point is that (i) it is now and has long been settled that Section 2038 does not cover a power or right subject to a conditional event which has not occurred prior to and does not exist at the decedent's death, such as a discretionary power to distribute income or principal under specified conditions which have not occurred before the death, and (ii) the same rule has been and is applicable to Section 2036(a).

There is no question that taxpayer is correct as to the construction of Section 2038. That slant was given by the courts to the provision's predecessor under the 1939 Code (*see Jennings v. Smith*, 161 F.2d 74, 77–78 (2d Cir. 1947); *Estate of Want v. Commissioner*, 29 T.C. 1223 (1958), *rev'd on other grounds*, 280 F.2d 777 (2d Cir. 1960); *Estate of Kasch v. Commissioner*, 30 T.C. 102 (1958)), and the Treasury has itself adopted the same interpretation for the 1954 Code as well. Treasury Regulations on Estate Tax (1954 Code), Section 20.2038–1(a) and (b); *see also* Rev. Rul. 55–393, 1955–1 CUM. BULL. 448.

The initial and fundamental question we have to face is whether this settled understanding of Section 2038 necessarily governs Section 2036(a), as it now stands. We think not for two reasons which we shall consider in turn: first, that the critical points-of-view of the two provisions differ, and, second, that the regulations governing the two sections take diametrically opposed positions on the narrow issue of contingent rights and powers of the kind involved here.

The two separate provisions appear to diverge sharply in their perspective—the point from which the pertinent powers and rights are to be seen. Section 2038(a) looks at the problem from the decedent's death—what he can and cannot do at that specific moment. Excluded are contingent rights and powers (beyond the decedent's control) which are not exercisable at that moment because the designated contingency does not exist at that time. Section 2036(a), on

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decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death.

the other hand, looks forward from the time the decedent made the transfer to see whether he has retained any of the specified rights "for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death." This language makes the transferor's death one pole of the specified time-span but the whole of the time-span is also significant. Because of the statute's reference to the time-span, differences of interpretation are quite conceivable. It is possible, for instance, to hold the words to mean that the retained right has to exist at all times throughout one of the periods, but it is also possible to see the language as covering contingencies which could realistically occur at some separate point or points during the designated periods—always including the moment of decedent's death. We take it (from the argument's insistence on the parallel to 2038) that that taxpayer would not stand on the former ("at all times") interpretation if a vacancy in the trusteeship existed and had not been filled at Mrs. Farrel's death. But under the language of 2036(a) there is no compelling reason why the moment of death has to be exclusively important. Unlike Section 2038, this provision seems to look forward from the time of transfer to the date of the transferor's death, and can be said to concentrate on the significant rights with respect to the transferred property the transferor retains, not at every moment during that period, but whenever the specified contingency happens to arise during that period (so long as the contingency can still occur at the end of the period).

There is nothing unreasonable about this latter construction, which accords with Congress' over-all purpose to gather into the estate tax all transfers which remain significantly incomplete—on which the transferor still holds a string—during his lifetime. It is hard to believe, for instance, that, whatever may be true of 2038, 2036(a) would have to be seen as failing to cover a trust where the trustee, with discretionary powers, could be removed by the settlor, and the settlor substituted as trustee, whenever economic conditions fell below a stated level (*e.g.*, a designated level on a certain stock exchange index or a

level of earnings of the trust) even though fortuitously that condition did not happen to exist at the time of death. In a case like that, the lifetime link between the decedent and the trust property (and income) would be so strong as plainly to measure up to both the letter and the spirit of 2036(a) if the Treasury chose to see it that way. This case, though perhaps less clear, falls into the same class of a continuing substantial tie.

The other element which leads us to reject plaintiff's attempt to equate 2036(a) with 2038, for this case, is that the Treasury has affirmatively chosen to separate the two sections—there is a Treasury regulation under the former § 20.2036–1 which, to our mind, clearly covers this decedent's situation (in contrast to the regulation under 2038 which excludes it).[6] Taxpayer urges us to read the regulation otherwise, and if we cannot to hold it invalid.

The regulation says flatly (*see* footnote 6, *supra*) that it is immaterial "(iii) whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death (*e.g.*, the death of another person during the decedent's lifetime)." This would seem on its surface to blanket this decedent's position under her trust, but plaintiff would read it very literally and narrowly to apply only where the contingency relates

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[6] In pertinent part (§ 20.2036–1(b)(3)) Treasury Regulations on Estate Tax (1954 Code), § 20.2036–1, provides:

(3) The phrase "right * * * to designate the persons who shall possess or enjoy the transferred property or the income therefrom" includes a reserved power to designate the person or persons to receive the income from the transferred property or to possess or enjoy nonincome-producing property, during the decedent's life or during any other period described in paragraph (a) of this section. With respect to such a power, it is immaterial (i) whether the power was exercisable alone or only in conjunction with another person or persons, whether or not having an adverse interest; (ii) in what capacity the power was exercisable by the decedent or by another person or persons in conjunction with the decedent; and (iii) whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death (e.g., the death of another person during the decedent's lifetime). The phrase, however, does not include a power over the transferred property itself which does not affect the enjoyment of the income received or earned during the decedent's life. (See, however, section 2038 for the inclusion of property in the gross estate on account of such a power.) Nor does the phrase apply to a power held solely by a person other than the decedent. But, for example, if the decedent reserved the unrestricted power to remove or discharge a trustee at any time and appoint himself as trustee, the decedent is considered as having the powers of the trustee.

to the "exercise" of an already existing power, and conversely, to be inapplicable where the power only springs into existence when a trustee vacancy occurs.[7] Similarly, taxpayer sees in the broad sweep of the last sentence of § 20.2036–1(b)(3) (fn. 6) the implied negative pregnant that a restricted power in the decedent to appoint herself a substitute trustee only in the event of a vacancy lies outside 2036(a). We cannot accept these strained (if not casuistic) analyses of the regulation because they go directly counter to its apparent purpose to cover just such contingencies as we have here. If proof of that objective is needed it is fully supplied by the companion regulation under 2038 (Treasury Regulation on Estate Tax (1954 Code), § 20.2038–1(b)) which declares in coordinate terms that "section 2038 is not applicable to a power the exercise of which was subject to a contingency beyond the decedent's control which did not occur before his death (*e.g.*, the death of another person during the decedent's life). *See, however, Section 2036(a)(2) for the inclusion of property in the decedent's gross estate on account of such a power*" (emphasis added).

We are required, then, to consider whether § 20.2036–1(b)(3) should be overturned as invalid. Recognizing the deference due Treasury Regulations (*Commissioner v. South Texas Lumber Co.*, 333 U.S. 496, 501 (1948); *Bingler v. Johnson*, 394 U.S. 741, 749–51 (1969)), we cannot take that step. We have pointed out that 2036 is not the same as 2038 in its wording or in the viewpoint from which it appraises the decedent's link to the transferred property. We have also said that it is not unreasonable to regard 2036(a), in the way the Treasury does, as a blanket overall sweeping-in of property over which the decedent still has at

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[7] Plaintiff's stand is that a power exists but is subject to a contingency as to exercise only if action may now be taken under it which will be effective upon the occurrence of some future event (*e.g.* a present power to alter contingent remaindermen whose rights will vest only on the death of the life tenant), while a power is subject to a contingency as to its existence if no action at all can be taken until a future event occurs (*e.g.* a power to name a successor trustee only in the event a vacancy occurs). This distinction seems to be suggested, as to the 1939 Code predecessor of Section 2038, in *Estate of Want v. Commissioner*, 29 T.C. 1223, 1242 (1958), *rev'd on other grounds*, 280 F.2d 777 (2d Cir. 1960). *See also Estate of Graham v. Commissioner*, 46 T.C. 415, 430–31 (1966) (Section 2038 of 1954 Code).

death some significant, though contingent, power to choose those who shall have possession or enjoyment.

To this, plaintiff's ultimate response is double-barreled: (i) the regulation was not contemporaneous with the adoption of the predecessor of 2036 but came years later, and (ii) for taxable years before the regulation was adopted courts applied the same rule to the predecessors of 2036 as they have to 2038 and its predecessors. Both points may be technically correct. The relevant regulation was promulgated in 1958 many years after the first predecessor of 2036 was enacted. And in 1947 *Jennings v. Smith, supra,* seemed to use, as an alternative holding, the same rule for the forerunner of 2036 that it applied to the predecessor of 2038. To the same effect was *Estate of Kasch v. Commissioner, supra* (1958) (predecessor section).[8] Nevertheless the Treasury was not foreclosed, in our view, from taking the position it did in 1958. As we have stressed, neither the text nor the purpose of 2036 demands that it be treated the same as 2038. The judicial observations lumping the two predecessor provisions responded to Government arguments treating the two sections as fully parallel on this point.[9] Moreover, *Jennings v. Smith* was the only appellate decision on the point which was outstanding when the 1958 regulations were promulgated, and its statement was, at best, a rather summary alternative holding[10] not truly necessary to the ultimate decision. Thus, the judicial interpretation of Section 2036's predecessor was neither so strong nor so encrusted that Congress may be thought to

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[8] In *Estate of Ralph Budd v. Commissioner,* 49 T.C. 468, 473–76 (1968), no contingent power or right was involved. The issue was whether the decedent's powers as trustee gave him the right to designate persons to enjoy or possess the trust property or income or to alter, amend or revoke the trust. As to one set of powers the court applied the "external standard" principle; as to the others the court ruled that they were not broad enough to meet the standards of either 2036 or 2038. Neither holding can apply here.

[9] Taxpayer has pointed out that the Treasury's regulation for 2038's predecessors sought to apply those provisions to the exercise of a power restricted to a particular time which had not arrived or the happening of a particular event which had not occurred at decedent's death. It was apparently not until the 1954 Code that the 2038 regulations were changed to their present form excluding such contingencies.

[10] In that instance, the court found that the retained contingent power was limited by a determinable, objective, external standard. Those "external standard" holdings are inapplicable here. *See* footnote 4, *supra.* It is not even clear from the *Jennings* opinion that the court intended its language as to contingent situations to apply where, as here, the trustee's powers were not subject to an external standard.

have embodied it in Section 2036 when it adopted the 1954 Code. On the contrary, we think the Treasury was free to take a new look under that new Code, as it evidently did. In sum, the current regulation under 2036 is a reasonable reading of the text and objective of the statute and the previous contrary judicial interpretation was not such that the Treasury was forced to bow to it despite the *prima facie* acceptability of the administrative stance.

We end by noting that the contingent right of Mrs. Farrel to make herself a trustee in the event of a vacancy—unlike the *de facto* "powers" involved in *United States v. Byrum*, 408 U.S. 125 (1972) and in *Estate of Tully v. United States*, 208 Ct. Cl. 596, 528 F.2d 1401 (1976)—was a legally enforceable right, in effect imbedded in the trust instrument, which bore directly on the designation of the persons to possess or enjoy the trust property or income. That the exercise of this right was foreseeable when the trust was created—that it was a real right, neither insignificant nor illusory—is shown by the fact that Mrs. Farrel had two opportunities to exercise it in eight years and, if she had lived, may well have had more.

CONCLUSION

For these reasons, we hold that plaintiff is not entitled to recover and the petition is dismissed.

KUNZIG, *Judge*, concurring:

I join in the opinion and judgment of the court, although with some difficulty. At the outset, I would not have decided the case in accordance with the majority, because I thought this court's decision in *Estate of Tully* v. *United States*, 208 Ct.Cl. 596, 528 F.2d 1401 (1976) demanded an opposite result. It is because I now think that *Tully*, applied to the facts of the instant case, requires a decision in favor of the Government that I state my views separately.

Tully involved the question whether death benefits paid directly to the deceased's widow by his employer should be included in the deceased's gross estate for estate tax purposes. 208 Ct.Cl. at 598, 528 F.2d at 1402. We decided

that the death benefits should not be included because they did not fall within either section 2038(a)(1) or section 2033 of the Internal Revenue Code. 208 Ct.Cl. at 606, 528 F.2d at 1407. I am concerned here as I believe that section 2038(a)(1), at issue in *Tully*, is closely analogous to section 2036, at issue in the instant case.

The court in *Tully* reached its conclusion as to section 2038(a)(1) only after deciding that Tully, the deceased, did not keep a section 2038(a)(1) "power" to "alter, amend, revoke or terminate" the enjoyment of the benefits after the transfer until his death. *Id.* In reaching this decision, the court applied the standard established by the court in *Harris* v. *United States*, 29 Am.Fed. Tax R. 2d 1558 (C.D. Cal. 1972), that is, that a section 2038(a)(1) power must be demonstrable, real, apparent and evident, not speculative. 208 Ct.Cl. at 602, 528 F.2d at 1404.

The deceased's power in *Tully* fell into the speculative range. Tully could have altered the terms of the death benefits agreement only with the cooperation of the other 50% owner of the corporation which was to pay the benefits. Tully's power, then, was the power of persuasion, not a "real" power within the *Harris* standard. Each owner in *Tully* had an equal stake in the corporation. Each, realizing that he might be the survivor, had an interest in keeping a reasonable ceiling on the size of the payments and in preventing frequent changes in the agreement. Each, therefore, acted as a brake on the other. 208 Ct.Cl. at 602–03, 528 F.2d at 1404–05.

But in the instant case, Farrel's power was not merely speculative. Certainly, if she had appointed herself as one of the two trustees (as explained in the majority opinion, *supra*), she would have been in the same "50%" situation as existed in *Tully*. There, however, the similarity stops.

Farrel, as settlor, had a greater stake in the distribution of trust income and corpus than did the other trustee, a stranger to the trust. I think that Farrel's dominant interest gave her a power "to designate the persons who shall possess or enjoy the property or the income" of the trust. IRC § 2036. I think that this "power" is within the parameters given that word by the court in *Tully* and as defined in *Harris*. The power is demonstrable, real,

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apparent and evident. It is for this reason, as well as for those stated by the majority, that I join in the judgment of the court.

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554 F.2d 427

PHILIP R. BENDURE, ET AL. v. THE UNITED STATES

[No. 204–75. Decided April 20, 1977]

ON DEFENDANT'S MOTION TO DISMISS

Civilian pay; environmental differential pay; exhaustion of administrative remedies; collective bargaining procedure in federal service.—Plaintiffs, wage-grade civil service employees of the Department of the Air Force and members of the American Federation of Government Employees (AFGE), claim entitlement to environmental differential pay (EDP) pursuant to 5 U.S.C. § 5343(c)(Supp. V, 1975) and the Federal Personnel Manual. They allege that their work requires them to be subject to health hazards which either have not been or cannot be eliminated or substantially reduced. The regulations provide no specific machinery for processing or settling EDP disputes between an agency and its employees as to whether or not a particular employment situation qualifies under the broad categories in Appendix J of the Manual, although they do allude to two possible methods of resolving EDP disputes, namely an agency grievance procedure provided in AF Supp., para. S8–7(a)(5), and the collective bargaining process. Plaintiffs' attempts to resolve the EDP issue through the collective bargaining process failed, in that the union did not take the matter to the Federal Service Impasses Panel as provided in Ex. Order 11491; and they did not follow the formal grievance procedure. Plaintiffs did apply to the Civil Service Commission for direct relief but the appeal was rejected on the ground that there is no right of appeal to the Commission regarding an agency decision concerning applicability of EDP, except when it affects the grade of a position. Defendant contends that the failure of AFGE to have the EDP dispute resolved by the Impasses Panel deprives this court of jurisdiction. It is *held* (1) that plaintiffs were not required to resort to the grievance procedure before bringing this action; resort would have been futile since absent appeal rights the administrative remedy was inadequate; (2) that plaintiffs' failure to resort to the Impasses Panel did not deprive this court of jurisdiction because the collective bargaining procedure is an optional right, not a mandatory remedy; (3) that the court lacks jurisdiction to review agency action in this area, and therefore plaintiffs can only enforce their statutory rights by original suit under the Tucker Act; (4) that where the court cannot review agency action, the doctrine of "exhaustion of administrative remedies" is inapplicable; and (5) that in

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view of 5 U.S.C. §§ 5343(c) and 5545(d) plaintiffs' statutory rights may not be extinguished by a collective bargaining agreement. Defendant's motion is denied, and the case is remanded to the trial division for trial or other disposition on the merits.

Civilian pay; administrative remedies; failure to exhaust; special circumstances.

[1] The judicial doctrine that requires a plaintiff to exhaust administrative remedies before resorting to the courts is not absolute. In the discretion of the court it may be waived when such unusual circumstances exist as to make application of the doctrine unjust.

Administrative Law and Procedure ⚖229

Civilian pay; administrative remedies; failure to exhaust; special circumstances.

[2] Generally, courts will refuse to require administrative exhaustion when resort to the administrative remedy would be futile, including situations where plaintiffs would be required to go through obviously useless actions in order to preserve their rights. Thus, where the Civil Service Commission notified plaintiffs that there was no right of appeal to it from an agency decision concerning the applicability of environmental or hazard pay plans, the agency grievance procedure, depending as it does upon the right of appeal, could not have been complete in the manner required to provide an adequate administrative remedy. Furthermore, since the agency's position is that the issues raised by plaintiffs were to be dealt with only within the collective bargaining process, had plaintiffs tried to use the grievance procedure it is unlikely that the agency would have ruled on the matter.

United States ⚖39(11)

Civilian pay; administrative remedies; exhaustion of administrative remedy.

[3] Implicit in the doctrine of exhaustion of administrative remedies is the assumption that a court has jurisdiction to review the decision of the agency having the power to grant relief in the first instance and to render judgment for the claimant if the decision is found to be fraudulent, arbitrary, capricious, or contrary to law. Therefore, where the courts have no jurisdiction to review the administrative decision, the doctrine does not apply except in cases where the agency has exclusive jurisdiction.

Administrative Law and Procedure ⚖229

Civilian pay; administrative remedies; exhaustion of administrative remedy; collective bargaining procedure in federal service.

[4] Since the collective bargaining procedure authorized by Ex. Order 11491, as amended, and para. S8–7g(3) of the Federal Personnel Manual 532–1, provides only an optional, permissive remedy through recourse to the Federal Service Impasses Panel which may but is not required to grant relief, the doctrine of exhaustion of administrative remedies is inapplicable; if the Panel refuses to consider the appeal or if it declines to grant relief, there is no right to judicial review. Consequently, under

such circumstances a plaintiff has the right to sue under this court's basic jurisdictional grant, the Tucker Act.

Federal Civil Procedure ⚖1102

Civilian pay; administrative remedies; exhaustion of administrative remedy.

[5] The doctrine of exhaustion of administrative remedies may not be interposed to stay the exercise of a court's jurisdiction when the administrative remedy is inadequate.

Administrative Law and Procedure ⚖229

Civilian pay; administrative remedies; exhaustion of administrative remedy; collective bargaining procedure in federal service.

[6] Despite the salutary objectives which led to promulgation of Ex. Order 11491 authorizing collective bargaining procedures in federal service, the right provided to an employee by 5 U.S.C. §§ 5343(c) and 5545(d) to receive pay differentials for duty involving unusually severe hazards may not be abrogated or denied because of failure of the employee's union to obtain a collective bargaining agreement which permitted environmental differential pay.

United States ⚖39(5)

James R. Rosa, attorney of record for plaintiff. *L.M. Pellerzi*, of counsel.

Vincent M. Garvey, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Senior Judge*, NICHOLS and BENNETT, *Judges*.

COWEN, *Senior Judge*, delivered the opinion of the court:

This case is before the court on defendant's motion to dismiss the petition, contending that the court lacks jurisdiction over the subject matter of the suit. Defendant maintains that the plaintiffs' claims have been the subject of collective bargaining negotiation, and that as a matter of law and judicial policy the court may not reconsider subjects which have been so negotiated. We disagree with defendant and for the reasons set forth below, deny its motion.

Plaintiffs are 47 wage-grade civil service employees of the Department of the Air Force at the Aerospace Guidance and Metrology Center, Newark Air Force Station, Newark, Ohio. Their employment engages them in a wide variety of tasks, including: "inertial gyro" cleaning

and repair, guided missile renovation and maintenance, "micro-soldering component" inspection, "inertial guidance systems" cleaning, electroplating, and boiler and "dravo heater" cleaning.

Plaintiffs allege in their petition that their work requires them to be subject to a number of health hazards which either have not been or cannot be eliminated or substantially reduced. These hazards include dealing with toxic chemicals and acids, using flammable substances and explosives, breathing in toxic gases and fumes, and cleaning up with harmful solvents. Plaintiffs seek to obtain compensation for these allegedly undue risks through hazard pay of between 4 and 8 percent of their salaries.

The specific form of hazard pay sought by plaintiffs is known as Environmental Differential Pay (EDP). It is established in appendix J to the Civil Service Commission's Federal Personnel Manual 532–1 (hereafter FPM 532–1), which lists the categories of work for which EDP may be sought, the job situations within each category, and the percentage differential applicable to each category. Plaintiffs contend that their job duties, while not mentioned in appendix J should be covered by various categories listed in the appendix. The categories for which plaintiffs seek EDP allowances are: "micro-soldering" (Part I, category 8); use of poisons (Part II, category 4); "dirty work" (Part I, category 4); and handling of explosives (Part II, category 2). They claim that they have been entitled to EDP under these categories from as far back as November 1, 1970.

The statutory basis of plaintiffs' claim appears in 5 U.S.C. § 5343(c) (Supp. V, 1975), which provides, in pertinent part:

> The Civil Service Commission, by regulation, *shall prescribe* practices and procedures for * * * developing and establishing wage schedules and rates, and administering the prevailing rate system. The regulations *shall provide*—
>
> * * * * * *
>
> (4) for proper differentials, as determined by the Commission, for duty involving unusually severe working conditions or unusually severe hazards; * * * [Emphasis added.]

In executing its statutory duty to prescribe regulations, the Civil Service Commission established a system of environmental pay in the Personnel Manual. Paragraph S8–7(f) of FPM 532–1 provides:

> (1) An agency *shall pay* the environmental differential in appendix J to a wage employee paid under a Federal Wage System wage schedule when the employee is performing assigned duties which expose him to an unusually severe hazard, physical hardship, or working condition listed in appendix J, on or after the effective date specified. [Emphasis added.]

The Personnel Manual further enumerates the circumstances and situations in which EDP "shall be paid." However, the regulations provide no specific machinery for processing or settling disputes between an agency and its employees as to whether or not a particular employment situation qualifies under the broad categories of the appendix.

Although no dispute-settling machinery is provided, the regulations do make allusion to two possible methods of resolving EDP disputes. The first of these is the normal agency grievance procedure, the administrative machinery for handling most local controversies.

Mention of the agency grievance procedure as a method of handling EDP disputes first appears in the Air Force Department's personnel manual (hereafter AF Supplement), which it issued to supplement the Civil Service Commission manual. In a question-and-answer section of the AF Supplement, apparently prepared for the agencies by the Civil Service Commission "in response to a number of agency requests," the following statement appears:

> (5) *Question.* How are EDP complaints processed?
>
> *Answer.* Complaints relative to environmental differential pay are processed in accordance with the grievance procedures in AFR 40–771. [AF Supplement, para. S8–7(n)(5).]

Air Force Regulation 40–512, mentioned in the AF Supplement, applies by its own terms "to an appeal concerning the applicability of the environmental and hazard pay differential plans; except for those provisions specifically applicable to the classification of an employee's

position." The procedure established by the regulation requires that a complaint be filed before the pertinent Central Civilian Personnel Office, (CCPO) which then:

> (1) Investigates the circumstances which are the basis for the appeal, and grants the appeal if it is justified. (2) If a decision favorable to the employee cannot be made, the CCPO prepares an appeal file and transmits it within 30 calendar days to the appellate level having jurisdiction for decision. [AFR 40–512, para. 17(a).]

Appeal from the CCPO's decision is to the Air Force Major Command in Washington, and Command's decision is final.

Plaintiffs did not follow this customary grievance procedure, as provided in the regulation. However, they did make application to the Civil Service Commission for direct relief on their individual claims. In a letter dated May 10, 1972, the Commission's legal staff replied that:

> * * * an employee is entitled to appeal to the Commission the grade, title or series assigned his job, but not the standards established for the job, nor other matters such as his rate of pay, or the propriety of a wage schedule. The system makes no provisions for an employee to appeal to the Commission with respect to any other action by an employing agency.
>
> * * * * *
>
> In short, *there is no right of appeal to the Commission with regard to agency decisions concerning the applicability of environmental or hazard pay plans except when it affects the grade of a position.* [Emphasis added.]

Plaintiffs apparently felt, upon receiving this letter from the Civil Service Commission, that they had exhausted their administrative remedies.

The second possible avenue which the regulations mention as being available to process claims such as plaintiffs advance here, is the collective bargaining process. The principal allusion to the collective bargaining process is found in the FPM Supplement 532–1, para. S8–7g(3), which reads in part:

> *Nothing in this section shall preclude negotiations through the collective bargaining process* for determining the coverage of additional local situations under appropriate categories in appendix J or for determining

additional categories not included in appendix J for which environmental differential is considered to warrant referral to the Commission for prior approval * * *. [Emphasis added.]

Plaintiffs are all members of Local 2221 of the American Federation of Government Employees (AFGE), which has been their exclusive labor representative since June 10, 1969. In 1971 the union began negotiation for an employment contract which would make provision for environmental differential pay. However, labor and management were unable to agree upon the "standards * * * which were to serve as the basis for determining if particular work situations met the requirements of Appendix J * * *." The Federal Mediation and Conciliation Service was unable to mediate the dispute, and the parties reached an impasse in November 1971.

At first, the union evinced an intention to take the matter to the Federal Service Impasses Panel, as provided by Executive Order 11491 (hereafter E.O. 11491). However, the AFGE local apparently changed its mind, and the parties signed a contract in 1972 which made no mention of EDP coverage. Although the union raised the matter again in 1975 when it negotiated a new contract, it did not succeed in obtaining an EDP coverage provision. The union made no attempt to submit the matter to an Impasses Panel on the 1975 contract.

While no EDP has been provided for the positions held by plaintiffs, there is some EDP coverage available to other Newark employees. This coverage arose as a result of an examination by medical and safety officers, classification and standards personnel, and a Bio-Environmental team from the Air Force Medical Center at Wright-Patterson Air Force Base. Upon completion of the study, the installation Commander, C. M. Burkhard, recommended to the CSC on November 12, 1970, that one "local situation" be covered by EDP, and that no new categories needed to be established in addition to those covered by appendix J.

The attempt to resolve the issue regarding EDP for plaintiffs through the collective bargaining process has not been successful, and plaintiffs' resort to the agency

grievance procedure was abortive. They did not follow the formal grievance mechanism.

I.

As its principal ground for dismissal of plaintiffs' petition, defendant contends that the failure of plaintiffs' union to have the EDP dispute resolved by the Federal Service Impasses Panel, as provided by Executive Order 11491, deprives this court of jurisdiction. This argument is based on a defense frequently asserted by the Government, namely, that the failure of a claimant to exhaust an available administrative remedy requires the court to dismiss his petition.

Before we discuss defendant's main contention, we first consider whether plaintiffs have a right to sue in this court because they did not utilize the remedy provided by the agency grievance procedure.

The inquiry must begin by noting at the outset that EDP is a specific, statutory right granted by Congress to Government employees; it grants them extra pay in those situations where the tasks of their work subject them to inescapable environmental risk. 5 U.S.C. § 5343(c). However, neither Congress in granting the right, nor the Civil Service Commission in promulgating regulations to "provide" for that right, has provided a mechanism to resolve disputes concerning the applicability of EDP to particular situations. As a result, there presently exists no means for employees to secure their rights when the agency disagrees with them, and the lack of such an adequate procedure means there is less restraint on agency denial of applications for EDP.

The judicial doctrine that requires a plaintiff to exhaust administrative remedies before resorting to the courts is not absolute. In the discretion of the court, it may be waived when such unusual circumstances exist as to make application of the doctrine unjust. *Shubinsky v. United States*, 203 Ct. Cl. 199, 203, 488 F.2d 1003, 1006 (1973); *Piccone v. United States*, 186 Ct. Cl. 752, 759, 407 F.2d 866, 869 (1969).

Courts will, as a general rule, refuse to require administrative exhaustion when resort to the administrative remedy would be futile, including situations where plaintiffs would be "required to go through obviously useless motions in order to preserve their rights." *Walsh v. United States*, 151 Ct. Cl. 507, 511 (1960), *cert. denied sub nom. Alexander*, 365 U.S. 880 (1961); *see also Am. Fed. Govt. Employees v. Paine*, 436 F.2d 882, 896 (D.C. Cir. 1970).

There are several circumstances in this controversy which indicate that any resort by plaintiffs to the agency grievance procedure would have been futile. Foremost among these is that as a result of the Commission's interpretation of its jurisdiction,the grievance procedure could not have been completed in the manner required to provide an adequate administrative remedy. The grievance procedure, by its own terms, depends upon the right of appeal from a hearing examiner's report to the full Civil Service Commission. In the absence of such appeal rights, the grievance procedure is inadequate, amounting to little more than an internal shifting of decision making within the employing agency. With respect to the claims before us, the Civil Service Commission notified plaintiffs in no uncertain terms that there was "no right of appeal to the Commission with regard to agency decisions concerning the applicability of environmental or hazard pay plans * * *." In other words, if the agency persisted in its contention that no EDP was allowable, there was no other forum where plaintiffs could seek redress.

A similar situation was before the court in *Booth v. United States*, 193 Ct. Cl. 790, 436 F.2d 474 (1971). There, plaintiffs' agency had recommended to the Commission that plaintiffs be authorized hazardous duty pay, but the request was denied and there was no provision for the employees to appeal from the denial on their own accord. The Commission offered, after the case was submitted to the court, to grant a special hearing to plaintiffs, but under the circumstances, we held that such a permissive remedy was insufficient and that "there was no other administrative remedy available to these plaintiffs." *Id.*, at 794, 436 F.2d at 476. The same considerations that led us to this

conclusion in *Booth* persuades us that the administrative remedy was inadequate in this case.

Even if plaintiffs had tried to use the grievance procedure, it is unlikely that the agency would have ruled on the matter. The Air Force's regulation AFR 40–771, section A, paragraph 7d. provides that the agency will not make any "decision" upon any grievance questions which concern "matters that management is obligated to discuss with an exclusively recognized labor organization * * *." It has been the position of the Air Force from the early stages of this controversy that the issues raised by plaintiffs were to be dealt with in labor negotiation, and therefore that the "existing instructions on environmental differentials do not provide for an appeals procedure" under the grievance system.

In short, had plaintiffs attempted to pursue the administrative grievance procedure (1) it is highly probable that they would not have been able to obtain a decision on the matter, because the agency felt the subject to be cognizable only within the collective bargaining process; and (2) even if plaintiffs had been able to obtain an agency decision, they would have had no appeal right to the Civil Service Commission. Under the circumstances, we hold that plaintiffs were not required to resort to the grievance procedure before bringing this action.

II.

The defendant advances two arguments in reliance on the collective bargaining procedure provided by Executive Order 11491, as amended.[1] As previously indicated, plaintiffs' union, AFGE Local 2221, unsuccessfully attempted to negotiate an agreement with officials of the Newark Air Force Station which would provide EDP for plaintiffs and other employees similarly situated. Defendant argues vigorously that when the matter reached an impasse, plaintiffs' exclusive remedy was an appeal by the union to the Federal Service Impasses Panel and that the failure of the union to resort to the Panel is a course of action which

[1] 34 Fed. Reg. 17605 (1969), amended by E.O. 11616, 36 Fed. Reg. 17319 (1971); E.O. 11838, 40 Fed. Reg. 5743 (1975); and E.O. 11901, 41 Fed. Reg. 4807 (1976).

binds plaintiffs and conclusively bars their right to maintain this action. We think that the provisions of section 17 of the Executive Order and also paragraph S8–7g(3) of FPM 532–1, the Commission's implementing regulation, demonstrate quite clearly that the use of the collective bargaining process and the right to appeal to the Panel is at the most an alternative, permissive remedy which in no way deprives this court of jurisdiction.

Paragraph S8–7g(3) of the regulation begins with the statement: "*Nothing in this section shall preclude negotiations through the collective bargaining process* * * *." [Emphasis added.]

Section 17 of the Executive Order, entitled "Negotiation impasses," reads as follows:

> When voluntary arrangements, including the services of the Federal Mediation and Conciliation Service or other third-party mediation, fail to resolve a negotiation impasse, either party *may* request the Federal Service Impasses Panel to consider the matter. The Panel, in its discretion and under the regulations it prescribes, *may* consider the matter and *may* recommend procedures to the parties for the resolution of the impasse or may settle the impasse by appropriate action. Arbitration or third-party fact finding with recommendations to assist in the resolution of an impasse *may* be used by the parties only when authorized or directed by the Panel. [Emphasis added.]

It is abundantly clear from the matter quoted that the right to utilize the collective bargaining procedure is only an optional right or remedy which is not precluded but certainly is not mandatory. Also, section 17 plainly states that resort to and action by the Impasses Panel is wholly discretionary. If there were any doubt that the collective bargaining procedure is merely a permissive avenue of relief, we think the doubt was erased by a recent decision of the Assistant Secretary of Labor for Management Relations, acting pursuant to his responsibilities under Executive Order 11491. *In re Am. Fed. Govt. Emp. AFL-CIO, Local 902*, No. 20–4753 (CA) (1975). Plaintiff's Attachment B.

In interpreting section 17 of the Executive Order, the decision read in pertinent part as follows:

> * * * In my view, Section 17 of the Order must be read literally when it states that "either party *may* request" [emphasis added] the services of the Panel when an impasse in negotiations has been reached. Nothing in the Order or its "legislative history" supports the conclusion that the services of the Panel must be requested to consider an impasse under the circumstances outlined by the Administrative Law Judge. In the absence of specific countervailing evidence, I can only conclude that the framers of the Order intended to give the parties discretion with respect to seeking the Panel's services. * * *

We emphasize, as do plaintiffs, that this is an interpretation which was "rendered by the President's appointed agent for the administration of Executive Order 11491."

Defendant's alternative position is that if the court concludes that an appeal to the Federal Service Impasses Panel is not an exclusive remedy, it is at a minimum a mandatory administrative remedy which must be exhausted prior to suit. Surprisingly, defendant couples this assertion with the contention that Executive Order 11491 provides no right to judicial review.[2] We find that these contentions are conflicting and in any event conclude that the doctrine of exhaustion of administrative remedies has no application in this case.

In discussing the doctrine of exhaustion of administrative remedies, the Supreme Court has declared that it is a rule which is "concerned with promoting proper relationships between the courts and administrative agencies charged with particular regulatory duties. 'Exhaustion' applies where a claim is cognizable in the first instance by an administrative agency alone; judicial interference is withheld until the administrative process has run its course. * * *" *United States v. Western Pac. R. Co.*, 352 U.S. 59, 63 (1956). Implicit in the doctrine of exhaustion is the assumption that a court has jurisdiction to review the decision of the agency having the power to grant relief in the first instance and to render judgment for the claimant if the decision is found to be fraudulent, arbitrary, capricious, or contrary to law. Therefore, where the courts

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[2] Defendant's moving brief at p. 18, n. 42.

have no jurisdiction to review the administrative decision, the doctrine does not apply except in cases where the agency has exclusive jurisdiction. In this case, as defendant has acknowledged, all of the courts which have considered the question have held that Executive Order 11491 was not issued "under statutory authority providing for presidential implementation or effectuation of statutory provisions" and therefore that it confers no jurisdiction on the courts under the Tucker Act to review the agency action. *Local 1498, Am. Fed. of G. Emp. v. American Fed. of G. Emp.*, 522 F.2d 486, 491, (3d Cir. 1975). The United States Court of Appeals for the District of Columbia Circuit has described the status of the Executive Order as follows:

> Executive Order 10988 represents in essence a formulation of broad policy by the President for the guidance of federal employing agencies. It had no specific foundation in Congressional action, nor was it required to effectuate any statute. It could have been withdrawn at any time for any or no reason. * * *
>
> * * * * * *
>
> The President did not undertake to create any role for the judiciary in the implementation of this policy. * * *
>
> [*Manhattan-Bronx Postal Union v. Gronouski*, 350 F.2d 451, 456 (1965).]

Since the collective bargaining procedure authorized by the Executive Order provides only an optional remedy through recourse to the Impasses Panel which may but is not required to grant relief, it follows that the doctrine of exhaustion is inapplicable; if the Panel refuses to consider the appeal or if it declines to grant any relief, there is no right to judicial review. *Medbury v. United States*, 173 U.S. 492, 497 (1899). Thus it is that the alleged administrative remedy upon which the defendant rests its motion falls in the same category as a permissive administrative remedy which this court dealt with in *Booth v. United States, supra*. Consequently, plaintiffs have the right to sue under our basic jurisdictional grant, the Tucker Act.

It is also well settled that the exhaustion doctrine may not be interposed to stay the exercise of a court's jurisdiction when the administrative remedy is inadequate.

United States v. Carlo Bianchi & Co., 373 U.S. 709 (1963). In an effort to overcome this obstacle, the defendant makes several tenuous arguments. First, defendant says plaintiffs can encourage their union representatives to put forth a proposal for EDP when the contract comes up for renegotiation, and if the proposal is not adopted, they can urge the union to take the issue to the Impasses Panel. Since plaintiffs have already traveled this unsuccessful route for several years, we cast aside this contention as the kind of obviously useless motion which we rejected in *Walsh v. United States, supra.* Secondly, defendant suggests that plaintiffs may *possibly* file suit against their union for breach of its duty of fair representation. We first observe that since an appeal by the union to the Panel is, by the express terms of Executive Order 11491, left completely in the discretion of the union, plaintiffs' chances of prevailing in such a suit would be extremely remote. More to the point, we know of no authority—and defendant cites none—which requires a litigant to abandon his suit in a court which has jurisdiction of his cause of action, and to sue in another to require resort to any administrative agency which has complete discretion to decline jurisdiction.

Defendant's final argument is that even if we hold that we have jurisdiction, the court should, in its discretion, decline to exercise that jurisdiction for to do so would interject the court into the collective bargaining process.

As previously indicated, plaintiffs' union and officials of the Newark Air Force Station have entered into several collective bargaining agreements, including the 1975 contract which is still in effect. Doubtless during these negotiations each of the parties asked for concessions which were ultimately abandoned and omitted from the contract. Either of the parties dissatisfied with the results of the negotiation had the right to appeal to the Panel for assistance in resolving impasses, but neither chose to do so. To us, the failure of the union to seek the intervention of the Panel is an indication that Local 2221 considered that it was in the best interests of all members of the union to sign the 1975 contract and drop the request for EDP coverage. Under these circumstances, we are not persuaded

that the exercise of the court's jurisdiction would involve an unwarranted intrusion into the collective bargaining process. Even if we were so persuaded, however, there is a fundamental and overriding principle which constrains us to deny defendant's motion. In sharp contrast to the optional and permissive provisions of Executive Order 11491 are the manadatory provisions of the applicable statute. Title 5, U.S.C. § 5343(c) (Supp V, 1975) states:

> * * * The [Civil Service Commission] regulations *shall* provide—
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> * * * * *
>
> (4) for proper differentials, as determined by the Commission, for duty involving * * * unusually severe hazards; * * *. [Emphasis added.]

Similarly, 5 U.S.C. § 5545(d) requires that:

> The Commission *shall establish* a schedule or schedules of pay differentials for * * * duty involving unusual physical * * * hazard. * * * [Emphasis added.]

There is of course a factual issue as to whether plaintiffs perform duties which expose them to hazardous working conditions as defined in the regulations. (Appendix J to FPM Supplement 532–1, subchapter S8.) However, if plaintiffs can establish in a court trial that their duties involve such working conditions, the statute requires that they receive the extra pay. Despite the salutary objectives which led the President to promulgate Executive Order 11491, it is our opinion that this statutory right may not be abrogated or denied to plaintiffs because of the failure of plaintiff's union to obtain a collective bargaining agreement which permitted EDP for plaintiffs. In reaching this conclusion, we rely on *Tennessee Coal & RR v. Muscoda Local 123, UMW*, 321 U.S. 590 (1944) and *Jewel Ridge Coal Corp. v. Local 6167, UMW*, 325 U.S. 161 (1945). In the first of these decisions, the Supreme Court held that the right of miners to be compensated for underground travel time was required by the Fair Labor Standards Act and that a collective bargaining agreement to the contrary could not be utilized to deprive the employees of their statutory rights. We think the rights afforded plaintiffs under the EDP provisions of Title 5 U.S.C. are of the same nature as

those dealt with by the Supreme Court in the cited cases, and that these rights may not be extinguished by a collective bargaining agreement.

III.

It follows from the foregoing that defendant's motion is denied. The case is hereby returned to the Trial Division for trial or other disposition on the merits.

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553 F.2d 1250

TIMBER ACCESS INDUSTRIES CO., INC. v. THE UNITED STATES

[No. 180–75. Decided April 20, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

Contracts; interpretation; Forest Service timber cutting contract; redetermination of rates for unscheduled contract extension; bid premium.—Plaintiff seeks review under Wunderlich Act standards of determinations respecting two timber cutting contracts ("Horse Creek" and "Failor Ridge") by the Department of Agriculture Board of Forest Appeals adverse to plaintiff that the redetermined price for an unscheduled contract extension was to be calculated according to the standard method provided in the Forest Service Manual. As to the "Horse Creek" contract, it is *held* that the Forest Service Manual must be read into the contract; that although the Manual's terms are not published in the Federal Register, plaintiff is bound by its terms due to its knowledge of the Manual; that the contract and Manual, read together, provide a comprehensive scheme for calculating rate redeterminations; that the scheme requires reappraisal based on the sale as a whole; that the bid premium should be added to the reappraisal value in arriving at the redetermined rate; that plaintiff's procedural challenge to the board's finding that the appeal respecting the "Failor Ridge" contract was untimely is moot in view of the board's correct decision on the merits in "Horse Creek"; that the issue of plaintiff's failure to exhaust its administrative remedies concerning the 1973 extension of the "Horse Creek" contract is also moot; and that plaintiff has not shown legal error in the board decisions which withstand Wunderlich Act review. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted and the petition is dismissed.

Syllabus

Contracts; disputes; administrative decision; finality of on question of law.

[1] When issues for review under Wunderlich Act criteria are those of law, the court has the duty independently to review the decision of the administrative board which first passed on the issues.

Courts ⚖460

Contracts; interpretation; trade usage or practice.

[2] The term "standard method" used in the Forest Service Manual in referring to timber sale rate redeterminations has become "trade usage" and a term of art for those engaged in contracting with the Forest Service; a knowledgeable contractor understands the term and a contractor, if it is not so knowledgeable, is charged with making itself aware of such usage.

Customs and Usages ⚖12(1)

Regulations of Executive Department; publication in Federal Register; notice.

[3] While substantive rules of the Forest Service are required to be published in the Federal Register and ordinarily a rule cannot bind or adversely affect a person absent publication, where a person has actual and timely notice of the terms thereof he is bound absent publication.

Woods and Forests ⚖7

Contracts; interpretation; Forest Service timber cutting contract; rate for unscheduled extension.

[4] Interpretation of a contract which would leave a vital provision without meaning should be avoided whenever possible in favor of one that gives a reasonable meaning to all parts of the instrument. Thus, in view of the complementary relationship of the subject timber cutting contract and the Forest Service Manual, both documents form a comprehensive scheme for redetermining rates for unscheduled extensions, and direct that the timber be reappraised on the basis of the sale as a whole.

Woods and Forests ⚖7

Contracts; interpretation; ordinary meaning of terms.

[5] In interpreting contract terms, the words are to be given their plain and ordinary meaning.

Contracts ⚖152

Contracts; interpretation; Forest Service timber cutting contract; rate for unscheduled extension; "bid premium".

[6] A "bid premium," i.e., an amount in excess of the Forest Service appraised value which a contractor is willing to pay for the right to cut and remove timber, should be added to the reappraised value in calculating the redetermined rate for an unscheduled extension of the contract, as representing the price the contractor must pay for being allowed such extension without having to fight competition to successfully rebid, rather than a penalty.

Woods and Forests ⚖7

James R. Moore, attorney of record, for plaintiff. *Neva T. Campbell*, of counsel.

R. W. Koskinen, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, KASHIWA, and KUNZIG, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

This case, involving extensions of timber sale contracts entered into between plaintiff-purchaser, Timber Access Industries Company, Inc. (Timber Access), and the United States Forest Service (Forest Service) is before the court on cross-motions for summary judgment. Two issues are presented. The primary one concerns interpretation of contract rate redeterminations for unscheduled extensions. The second (and subsidiary) issue involves administrative procedure. Our standard of review is established by the Wunderlich Act, 41 U.S.C. §§ 321, 322 (1970),[1] as this case comes before the court following a determination by the Department of Agriculture Board of Forest Appeals (Board) adverse to plaintiff.

We hold for defendant on the main issue of contract interpretation and, therefore, as explained *infra*, do not find it necessary to reach any subsidiary procedural questions.

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[1] The Wunderlich Act provides:

41 U.S.C. § 321 (1970). Limitation on pleading contract provisions relating to finality; standards of review.

No provision of any contract entered into by the United States, relating to the finality or conclusiveness of any decision of the head of any department or agency or his duly authorized representative or board in a dispute involving a question arising under such contract, shall be pleaded in any suit now filed or to be filed as limiting judicial review of any such decision to cases where fraud by such official or his said representative or board is alleged: *Provided, however*, That any such decision shall be final and conclusive unless the same is fraudulent (footnote omitted) or capricious or arbitrary or so grossly erroneous as necessarily to imply bad faith, or is not supported by substantial evidence.

41 U.S.C. § 322 (1970). Contract-provisions making decisions final on questions of law.

No Government contract shall contain a provision making final on a question of law the decision of any administrative official, representative, or board.

Timber Access was awarded two contracts for the sale of timber; the "Horse Creek" contract on July 6, 1966, and the "Failor Ridge" contract on July 3, 1969. Both involved timber located in the Forest Service Pacific Northwest Region. The price to plaintiff for each contract included a "bid premium," an amount in excess of the Forest Service appraised value which plaintiff was willing to pay for the right to cut and to remove timber.

Each contract provided (in exactly the same terms) for extending time of performance and for adjusting the contract price for the extension period. The contract clause providing for rate redetermination in conjunction with a contract extension reads, in pertinent part, as follows:

> [R]ate redeterminations shall be made in accordance with the *standard method* in use at the time of rate redetermination and shall consider all facts which may affect timber value at the rate redetermination date. Contract Para. B3.31. (emphasis supplied)

As explained *infra*, the contracts at issue here were extended several times. Each time the Forest Service used the *standard method* in calculating the redetermined rates. To the Forest Service, the standard method was that set forth in the Forest Service Manual. In cases such as this, the method was applied by the Forest Service in the following way: First, the remaining timber was reappraised based on the "sale as a whole," that is as if the original stand of timber remained uncut. Timber industry data in effect 45 days before the expiration date of the contract was applied to determine the reappraised value. The bid premium from the original award was then added to the reappraised value, giving the redetermined rate. Only if the redetermined rates were higher than the current contract rates did the redetermined rates take effect.

The "Horse Creek" contract was extended four times. Each extension involved an increase in the contract price. (That is the redetermined rates were higher than the then-current contract rates, so the redetermined rates went into effect.) All of the rate redeterminations were computed according to the standard method, as set forth in the Forest Service Manual (outlined, *supra*). Plaintiff accepted the

first two without objection.[2] The last two, executed on August 10, 1972 and August 17, 1973 are contested. Timber Access accepted the August 10 extension under protest and appealed the price redetermination to the Board. The appeal was denied (Bd. No. 299). The August 17 extension was also accepted under protest, but no appeal was taken.

In denying plaintiff's appeal from the August 10, 1972 rate redetermination, the Board held that the Forest Service properly based the redetermination on the "sale as a whole," as if no timber had been cut, and held that the original bid premium was properly added to the reappraised timber value. Plaintiff challenges the Board's "Horse Creek" decision (No. 299) in this court and contests the August 17, 1973 rate redetermination, even though the Board did not pass on the 1973 redetermination.

The "Failor Ridge" contract was also extended with an increase in price following a rate redetermination. After preliminary negotiations with regard to this extension, the Forest Service, on December 11, 1972, advised plaintiff that it must either sign the proposed extension (which included a redetermined price based on reappraisal plus original bid premium), or allow the contract to expire. Plaintiff agreed to the extension under protest by letter of December 18, 1972. In this letter, plaintiff reserved its right to appeal. However, an appeal was not filed with the Regional Forrester until January 23, 1973. The Regional Forrester found December 11, 1972 the effective date of the contract extension and January 23, 1973 the date of the appeal. He then denied the appeal as not taken within the 30-day limit. Plaintiff appealed the Regional Forrester's determination to the Board.

In case number 320, the Board upheld the Regional Forrester's "Failor Ridge" decision. The 30 days runs, the Board said, from the date of receipt of a final decision

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[2] Plaintiff argues that the court should not attach any weight to its acceptance, without protest, of the first two redeterminations. Plaintiff's position is based on the claim that the two redeterminations were not before the Board and are not, therefore, part of the administrative record. While we are inclined to agree with plaintiff, *United States* v. *Carlo Bianchi & Co., Inc.*, 373 U.S. 709,714 (1963), we do not decide this question because we do not consider the first two redeterminations in reaching our conclusion.

(December 11, 1972) by a Forest Officer, 36 C.F.R. 211.30(a)(1972), not from the date the new rates become effective (January 1, 1973). Plaintiff also challenges the Board's "Failor Ridge" decision before this court.

Timber Access argues that the Boards in both the "Horse Creek" and "Failor Ridge" cases reached erroneous conclusions of law. Concerning the "Horse Creek" case, plaintiff contends that the Board incorrectly interpreted the contract. Price redeterminations made in conjunction with contract extensions, plaintiff states, should be made on the basis of the timber remaining at the time of the redetermination, not on the basis of the "sale as a whole." In support of its interpretation, plaintiff argues that the Forest Service Manual guidelines for price redeterminations are not binding on plaintiff for they do not conform to the contract and are not published in the Federal Register. In addition, plaintiff claims that the inclusion of the bid premium in the rate redetermination process constitutes the application of an illegal penalty against plaintiff and should, thereby, be disallowed.

With regard to the "Failor Ridge" Board opinion, plaintiff again contends that the Board reached an erroneous conclusion of law. Plaintiff claims, contrary to the Board's decision, that its appeal was timely. Further, plaintiff contends that even if not timely, its failure to exhaust administrative remedies with regard to both the extension of the "Failor Ridge" contract and the August 17, 1973 extension of the "Horse Creek" contract should be excused due to inadequacy of administrative remedies. *See Anthony Grace & Sons, Inc.* v. *United States*, 170 Ct.Cl. 688,695, 345 F.2d 808,812 (1965), *rev'd on other grounds*, 384 U.S. 424 (1966).

Defendant replies that the Board decisions in both the "Horse Creek" and the "Failor Ridge" appeals were correct. In "Horse Creek," defendant argues, the Board properly held that the standard method for price redetermination should apply, that this method is set forth completely in the Forest Service Manual, and that plaintiff is bound by this method.

In response to plaintiff's positions concerning the "Failor Ridge" decision, defendant urges that plaintiff's appeal in

the "Failor Ridge" contract was not timely and that plaintiff is barred from contesting the August 17, 1973 contract extension due to plaintiff's failure to exhaust its administrative remedies.

We hold for the Government.

Before we begin our discussion of the parties' arguments, a word on the scope of the court's review is in order. This is a Wunderlich Act case (*see* note 1, *supra*); therefore, our review is limited. However, when the questions for review are those of law, as in this case, the court has the duty independently to review the decision of the administrative board which first passed on the issues. *Anthony Grace & Sons, Inc.* v. *United States*, *supra* 170 Ct.Cl. at 695, 345 F.2d at 811–12; *Wingate Construction Co.* v. *United States*, 164 Ct.Cl. 131 (1964); *Beacon Construction Co.* v. *United States*, 161 Ct.Cl. 1, 314 F.2d 501 (1963); *P.L.S. Coat & Suit Corp.* v. *United States*, 148 Ct.Cl. 296, 180 F.Supp. 400 (1960).

1. *CONTRACT INTERPRETATION*

Plaintiff first contends that the contract alone controls the method of price redetermination and that this method results in a price based solely on the reappraisal value of the *remaining* timber. Defendant, of course, argues that the redetermined price is based on a reappraisal of the sale as a whole, plus the bid premium, as outlined in the Forest Service Manual which applies, claims defendant, by the terms of the contract.

a. Sale as a Whole

Our first task then is to determine whether the Forest Service Manual should be read into the contract. We begin our inquiry with the applicable contract language:

> B3.31 *Rate Redetermination Method*
>
> * * * * *
>
> [R]ate redeterminations shall be made in accordance with the *standard method in use at the time of the rate redetermination* and shall consider all factors which may affect timber value at the rate redetermination date. (emphasis supplied)
>
> * * * * *

The term *standard method* has become, so to speak, "trade usage" for those engaged in contracting with the Forest Service. The knowledgeable contractor should understand the language and if plaintiff (Timber Access) did not, it was nevertheless charged with making itself aware of the usage. *General Builders Supply Co., Inc.* v. *United States*, 187 Ct.Cl. 477,484, 409 F.2d 246,251 (1969).

The *standard method*, known to all contractors, is that set forth in the Forest Service Manual.[3] It is the same

[3] The Forest Service Manual provides, in pertinent part:
FSM § 2427.35
Rate Redetermination When Contract Period is Extended. If the contract is extended at the request of the purchaser a rate redetermination will be made either for the timber on the 'sale as a whole' or for the timber to be cut during the ensuing period depending upon the wording in A7 of the contract for sales with scheduled rate redetermination provision. For sales without scheduled rate redeterminations, extension rate redeterminations will be based on the sale as a whole.
1. The rate redetermination will be made as though the sale were a new sale being originally appraised, using the standard Forest Service appraisal method and data in effect 45 days prior to the expiration date. If the weighted average redetermined rates plus the weighted average bid premium rates on the volume remaining are greater than the weighted average current contract rates in effect immediately prior to the extension they will be placed in effect. Otherwise the rates in effect at time of extension will remain in effect. The proportion by species of the remaining volume can be the deciding factor in determining whether weighted average value of redetermined rates plus bid premium is higher than the weighted value of current contract rates applied to the remaining volume. For this reason a reliable estimate of the remaining volume by species should be made. The established rates for any species-product cannot be less than the current contract rate. Therefore, appraised rates for some species may need to be adjusted downward to compensate for establishing current contract rates for those species-products which appraise below current contract rates, in order that the redetermined plus bid premium value of the remaining timber will not be changed.* * *
FSM § 2453.31b
Rates After Scheduled or Emergency Rate Redetermination (B3.12). After a scheduled or emergency rate redetermination, the current contract rate for material not subject to escalation is the redetermined rate plus the bid premium rate. For material subject to escalation, the tentative rate is the redetermined rate plus the bid premium rate, and the current contract rate is this tentative rate adjusted by escalation. The bid premium is constant for the life of the contract and, hence, is added to the redetermined rate.
FSM § 2453.31e
Rates When Contract Term is Extended (B3.15). This subsection outlines the procedure which will be applied when the purchaser applies for a contract extension. Such contract extension automatically establishes a rate redetermination date effective on the date of the beginning of the contract extension. Such rate redetermination, however, is subject to a floor which is the rate in effect immediately prior to the date of the contract extension. This is a simple concept in connection with flat rates. Where escalation is involved, the rate redetermination will establish a new base index. * * *

method which has been given wide publicity since 1965 and has been used on 250 contract extensions in the Willamette National Forest (the site of the timber covered by this contract) and in thousands of other Forest Service sales.

Yet plaintiff claims that it is not bound by the standard method because the Forest Service Manual was not published in the Timber Regulations (36 C.F.R. 221.1 *et seq.*) or elsewhere in the Federal Register. Substantive rules of the Forest Service are required to be published in the Federal Register, 5 U.S.C. 552(a)(1)(D) (1970),[4] and ordinarily a rule cannot bind or adversely affect a person absent publication.

However, 5 U.S.C. 552(a)(1) provides an exception to this general rule. Even if a matter is not published in the Federal Register, a person is still bound if he has "actual and timely notice of the terms thereof." 5 U.S.C. 552(a)(1)(1970). In the case before the court, plaintiff comes within the exception. The record clearly shows that plaintiff had knowledge of the Forest Service Manual. During the course of negotiations preceding the contract modification, plaintiff in fact quoted part of the Manual to the Forest Service.

In addition, the contract itself invites the contractor to search out the meaning of *standard method. Cf. Bergen* v. *United States, ante* at 612, also decided this day, at note 3. Clause B3.15 directs the Forest Service to make rate redeterminations pursuant to clause B3.31, *supra.* Clause B3.31 refers specifically to the "standard method in use," but nowhere in the contract is the standard method defined. Since the Forest Service is limited to only the use of the *standard method,* it seems naive that plaintiff would read the contract without inquiring as to the meaning of this obviously important term. Just slight inquiry would have brought forth the information that *standard method* is a term of art. *See General Builders Supply Co., Inc., supra*

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[4] 5 U.S.C. § 552(a)(1)(1970):

Each agency shall separately state and currently publish in the Federal Register for the guidance of the public—

(D) substantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the agency . . .

187 Ct.Cl. at 484–85, 409 F.2d at 251; *Beacon Construction Co.* v. *United States*, 161 Ct.Cl. 1, 314 F.2d 501 (1963). *Cf. Space Corp.* v. *United States*, 200 Ct.Cl. 1, 470 F.2d 536 (1972).

Plaintiff, however, does not rest only on his claim that the Forest Service Manual does not apply because it was not published in the Federal Register. Timber Access also argues that it should not apply because the Manual is inconsistent with the contract and, in view of this alleged inconsistency, the contract should control. Plaintiff misses the point. The contract and the Forest Service Manual are not inconsistent, but are complementary. Read together, they form a comprehensive rate redetermination scheme, and direct that the timber be reappraised on the basis of the "sale as a whole."

The contract requires the Forest Service, in determining extension rates, to take into consideration "all factors which may affect timber value at the rate determination date." Contract clause B3.31. This refers to market forces in the base index for timber prices, inflation, and to costs involved in the harvesting of timber.

> The Forest Service Manual states that:
> ". . . for sales without scheduled rate redeterminations [such as is involved in this case], extension rate redeterminations will be based on the *sale as a whole.* The rate redetermination will be made as though the sale were a *new sale being originally appraised,* using the standard Forest Service appraisal method and the data in effect 45 days prior to the expiration date. FSM § 2427.35, *supra* note 3. (emphasis supplied)

This language illustrates that the redetermination is conducted as if the original timber stand remains unchanged. To this reappraisal are then added the factors (data) referred to in the contract as of the date specified in the Forest Service Manual.

To read the contract otherwise would leave the vital term "standard method" without meaning. Such a reading is to be avoided whenever possible in favor of one that gives

> . . . reasonable meaning to all parts of the instrument rather than leaving a portion of it useless. [*ITT Arctic*

Services, Inc. v. *United States*, 207 Ct.Cl. 743, 751–52, 524 F.2d 680, 684 (1975)]

See also, C. H. Leavell & Co. v. *United States*, 208 Ct.Cl. 776,800–01, 530 F.2d 878,891–92 (1976).

The complementary scheme we have outlined avoids such a situation. All parts of the contract are given a reasonable interpretation and a place in the rate redetermination process. Both parties to the contract are able, from the date of contracting, to ascertain future dealings under the contract with certainty.

Further, reading the contract and the Forest Service Manual as complementary fosters the doctrine of contract interpretation that words are to be given their plain and ordinary meanings.[5] *See Whelan v. United States*, 208 Ct.Cl. 688, 693, 529 F.2d 1000,1002–03 (1976); *ITT Arctic Services, Inc. v. United States, supra*, 207 Ct.Cl. at 752, 524 F.2d at 684; *Victory Construction Co. v. United States*, 206 Ct.Cl. 274,287, 510 F.2d 1379, 1386 (1975).

Thus the plain meaning of the language used plus the complementary relationship of the contract and Manual show clearly that the "sale as a whole" is the proper method by which to reappraise the timber. In addition, the common sense and logic of such an interpretation is made even more evident by the obvious opportunity for "game playing" under plaintiff's view.

Essentially, plaintiff is urging that the Forest Service, each time a contract is extended, conduct a new "cruise" of the timber to determine the type, size, location, and quality of it. Plaintiff contends that the result of the new cruise would be a lower reappraisal value, and hence, a lower redetermined rate. But the drawbacks to such a procedure are great. First, the cost to the Forest Service would be substantial. Second, a contractor could, through selective cutting, greatly affect any subsequent appraisal thereby reaping high profits and denying the Government a fair price for the timber. He could, for example, harvest the readily accessible above-average timber during the initial

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[5] We note here that plaintiff's *contra proferentem* argument is without merit. For the rule to apply, and the contract to be construed against the drafter (here, the Government) the contract must be ambiguous. In the instant case, the contract is clear. *See, e.g., S.W. Aircraft Inc.* v. *United States, ante* at 213.

term of the contract, thereby keeping his costs down, his selling price high, and maximizing his profits. Then, in negotiating the contract extension, he could argue for a low reappraisal based on the inaccessible and poorer quality timber remaining. This would again allow him to maximize his profits for, even though he would have higher costs and would be receiving less for his timber, he would also be paying the Government less.

We hold that the Forest Service Manual applies to this contract, and that FSM § 2427.35 requires that reappraisals be based on the "sale as a whole" as though the sale were a "new sale being originally appraised."

b. Bid Premium

The remaining contract issue concerns plaintiff's claim that the addition of the bid premium to the reappraised value of the timber is a penalty and therefore void. We begin by pointing out that the addition of the bid premium to the reappraised value of the timber is clearly required by the contract (clause B3.12), and it was on this point that the Board of Forest Appeals rested its decision. However, a finding that the addition of the bid premium is required by the contract does not end our inquiry. It could still be a penalty, and void.

Plaintiff argues the bid premium is a penalty because it bears no relationship to the fair market value of the timber. For support of this proposition, plaintiff relies on *In re Idaho Timber Co.*, F.S. Doc. No. 191. Plaintiff is in error. The bid premium *does* relate to the market value. At the time the contract was originally entered into, the bid premium reflected the amount by which a purchaser's bid exceeded the original appraised market value. Adding the bid premium to the reappraised market value in calculating the redetermined rate simply maintains (albeit approximately) the relationship that the bid premium had to the appraised market value at the time of the award.[6]

[6] Following plaintiff's argument to its logical conclusion, it would appear to work to his decided disadvantage. If, to be allowable, the bid premium must have an exact relationship to market value, then perhaps the Government would have the right to add an amount to the bid premium in order to maintain an exact relationship

To hold that the bid premium should never be included, as plaintiff requests, would allow a contractor to do minimal harvesting of timber during the original contract period, then, during the extension period, to cut great amounts of timber reaping a large profit while free from the cost imposed on him by the bid premium. This we cannot condone. After all, plaintiff originally bid the higher figure, including the bid premium, in order to win the contract. The inclusion, now, of the bid premium in the redetermined rates *is the price plaintiff must pay for being allowed to extend a contract without having to fight competition to successfully rebid.*

The case plaintiff cites, *Idaho Timber Co., supra,* is not controlling. The *Idaho Timber* decision prevents the Forest Service from measuring damages for breach of a timber sale contract by the difference between the original bid premium and a higher bid premium received by the Forest Service on resale. That is clearly a different situation from the instant case, which involves not the permissible method of calculating damages, but the proper method of rate redetermination.

Thus, in the instant case, we are left with the original contract provisions. They require payment of a bid premium, and we so hold.

To summarize *part 1,* the Forest Service Manual must be read into the contract. Even though the Manual's terms are not published in the Federal Register, Timber Access is bound by these terms due to its knowledge of the Manual. The contract and Manual, read together, provide a comprehensive scheme for calculating rate redeterminations. This scheme requires that the reappraisal be based on the "sale as a whole" and that the bid premium be added to the reappraisal value in arriving at the redetermined rate.

2. *PROCEDURAL QUESTIONS*

Plaintiff challenges the denial of its appeal in "Failor Ridge." The Board, finding the appeal untimely, had

between the bid premium and the reappraised market value (assuming that the reappraised value as in the instant case is higher than the original appraisal).

denied it. We agree with the Board's result, although reaching the same conclusion, as a matter of law, by a different route. *See Federal Electric Corp. v. United States*, 202 Ct.Cl. 1028,1040, 486 F.2d 1377,1383 (1973), *cert. denied*, 419 U.S. 874 (1974); *Maxwell Dynamometer Co. v. United* States, 181 Ct.Cl. 607,631, 386 F.2d 855,870 (1967). Because the issues presented by the merits of "Failor Ridge" are the same as those correctly decided by the Board in "Horse Creek," plaintiff's procedural arguments are moot.

A final issue remains: whether plaintiff's failure to exhaust its administrative remedies concerning the August 17, 1973 extension of the Horse Creek contract bars the court from considering the merits of plaintiff's appeal. *See Anthony Grace & Sons, Inc. v. United States, supra.* Assuming, *arguendo*, that plaintiff's claim is not barred, we reach the same result as in "Horse Creek" (part 1, *supra*); plaintiff fails on the merits. Therefore, plaintiff's "failure of administrative remedies" argument is also moot.

In light of the foregoing, we conclude that the Board's decisions in favor of the Government withstand Wunderlich review. Plaintiff has not shown legal error in either the "Horse Creek" of "Failor Ridge" Board decision.

Accordingly, after consideration of the briefs and record, and after hearing oral argument, plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted, and the petition is dismissed.

CONGRESSIONAL REFERENCE

(The following Report was filed pursuant to the Act of October 15, 1966, 80 Stat. 958, providing for the reporting of congressional reference cases by commissioners of the Court of Claims)

JOHN T. KNIGHT V. THE UNITED STATES

[Cong. Ref. No. 7–76. Filed February 14, 1977]

REPORT TO THE UNITED STATES SENATE

Congressional reference; disability retired pay.—The above-identified congressional reference is part of the claimant's continuing effort to recover disability retired pay. Reports of prior decisions by this court are found at: 152 Ct. Cl. 298 (1961); 163 Ct.Cl. 576 (1963); and 202 Ct.Cl. 1043 (1973). On February 14, 1977 the following report to the United States Senate was filed by the Review Panel in the present congressional reference.

Thomas H. King, attorney of record for plaintiff.

LeRoy Southmayd, Jr., with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Before Lloyd Fletcher, *Presiding Commissioner of the Review Panel,* Mastin B. White and David Schwartz, *Commissioners.*

By The Review Panel: On September 30, 1976, the Senate of the United States by Senate Resolution 572, 94th Cong., 2d Sess. referred to the Chief Commissioner of the Court of Claims H.R. 6852, a bill for the relief of Colonel John T. Knight, pursuant to 28 U.S.C. §§1492 and 2509 with instructions to inform the Congress of the amount, if any, legally or equitably due from the United States to the claimant.

The Chief Commissioner referred the case to Trial Commissioner C. Murray Bernhardt for proceedings in

accordance with the applicable rules and designated the above members of the Review Panel to consider the trial commissioner's decision on the matter thus referred by the Senate.

On February 9, 1977, Commissioner Bernhardt reported his decision concluding that John T. Knight is due the net sum of $106,340.33, representing total retired pay of $160,594.67 offset by a credit of $54,254.34 for disability compensation received from Veterans Administration.

Upon careful consideration of Commissioner Bernhardt's report, the Review Panel is in unanimous agreement with his opinion, findings, and conclusions, except for a minor modification, as hereinafter set forth. The Review Panel, therefore, without oral argument adopts the same (with a minor modification) as the basis of its recommendation that plaintiff has a valid legal claim against the United States and that the amount of $106,340.33 is due from the United States to the plaintiff.

This determination is accordingly submitted to the Chief Commissioner for transmittal to the Senate of the United States.

REPORT OF THE TRIAL COMMISSIONER

BERNHARDT, *Commissioner:* On September 11, 1973, pursuant to H. Res. 240, 92d Cong., 1st Sess., the Chief Commissioner of the Court of Claims forwarded to the Speaker of the House of Representatives the opinion of the Review Panel on the claim of John T. Knight for disability retirement compensation (202 Ct. Cl. 1043 (1973)). He recommended that, but for the bar of the statute of limitations, the claimant would have a legal claim against the United States, and further, that on the facts of the case the bar of limitations should be lifted.

No further legislative action was taken in the 92d Congress following the Chief Commissioner's report. In the 94th Congress S. Res. 572 was passed on September 30, 1976, referring to the Chief Commissioner H.R. 6852, a bill for the relief of the same John T. Knight, with instructions to report to the Senate his findings of fact and conclusions as to the claimant's legal or equitable entitlement from the United States.

Following receipt of S. Res. 572, and the filing of a new petition by the claimant (Cong. Ref. Case No. 7–76), a call was issued by the Chief Commissioner on the General Accounting Office for computation of the claimant's disability retirement pay from the date of his release from active duty on October 19, 1947. On December 30, 1976, the General Accounting Office advised that disability compensation pay due the claimant through December 31, 1976, totalled $160,594.67, less offsets of $54,254.34 for Veterans Administration disability compensation received, for a net amount due of $106,340.33. The parties have accepted the computation, although the defendant remains opposed to waiver of the statute of limitations. Since the original opinion of the Review Panel as transmitted to the Congress by the Chief Commissioner recommended that circumstances justified waiver of the statutory bar, and since further in all other respects the said original opinion of the Chief Commissioner is not challenged by the parties nor is there any request or purpose in a retrial of the issues, it is found that through December 31, 1976, the claimant is due the net sum of $106,340.33, representing total retired pay of $160,594.67 offset by a credit of $54,254.34 for disability compensation received from Veterans Administration.

ORDERS

No. 328–73. FEBRUARY 4, 1977

Donald R. Gratehouse

Civilian pay; claim of involuntary resignation; review of Civil Service Commission decision; what constitutes adverse personnel action.—On February 4, 1977 the court entered the following order:

Ben Paul Noble, attorney of record, for plaintiff. *Noble and Larsen*, of counsel.

Frank H. Clabaugh, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, NICHOLS and BENNETT, *Judges*.

"This case is before the court on plaintiff's motion and defendant's cross-motion for summary judgment. It was previously the subject of an opinion by the court. *Gratehouse* v. *United States*, 206 Ct. Cl. 288, 512 F. 2d 1104 (1975). That opinion remanded the case to the Civil Service Commission (the Commission) for a hearing on plaintiff's charge that his resignation was induced by defendant's coercion and deceit. Plaintiff, who was employed prior to September 4, 1971, as an economist, GS–13, Step 4, in the Department of Housing and Urban Development (HUD), resigned his position effective as of that date. He alleges that he did so through the deceit and coercion of HUD management, that this made his resignation involuntary and, in effect, an adverse action, and that he was denied the procedural protections afforded to those subject to adverse actions. He further says that he was granted a within-grade increase (WGI) in consideration of his resigna-

tion but such an exchange was contrary to law, thus voiding his resignation. He seeks back pay and reinstatement to his position.

"On October 6, 1975, the Federal Employee Appeals Authority (FEAA) of the Commission, pursuant to the order of remand and following a hearing, entered a decision in plaintiff's favor. On March 18, 1976, the Appeals Review Board (ARB) of the Commission, reversed the FEAA decision, concluding that plaintiff was not entitled to recover. The issue now before the court on the pending motions is whether the ARB decision is supportable by substantial evidence and correct as a matter of law. *Boyle* v. *United States*, 207 Ct. Cl. 27, 515 F. 2d 1397 (1975).

"The parties are agreed on the facts as found by FEAA and adopted by the ARB, which disagreed only as to the conclusions to be drawn from those facts. It is clear from these facts that defendant regarded plaintiff as less than a satisfactory employee and proposed to withhold a within-grade increase from him. He was so advised. Concerned that this would be a damaging mark on his personnel record, and in order to forestall the action, plaintiff submitted his resignation in writing under date of May 20, 1971, effective September 4, 1971, in exchange for simultaneous approval of a WGI for plaintiff. The post-dating of the resignation by plaintiff was to give him time to seek other employment.

"On September 1, 1971, plaintiff requested return of his resignation on the grounds of defendant's alleged 'illicit actions' and 'bad faith.' The request was not granted, but plaintiff was offered a 60-day temporary appointment in order to give him still more time to find another position. Plaintiff rejected the offer and appealed his separation unsuccessfully through civil service procedures. Additional historical details are outlined in our 1975 opinion. We were concerned at that time that the Commission had not evaluated plaintiff's claim of coercion and entitlement to adverse action procedures, hence the remand order which has now been complied with.

"The real thrust of plaintiff's claim is that he was tricked into signing his resignation in order to get his step increase and that this was illegal. It certainly would be illegal, and

his resignation void, if he was so deceived, but the evidence is to the contrary. It is absolutely clear from the findings and opinions of FEAA and ARB that the suggestion that plaintiff resign was plaintiff's own idea. The ARB finding sums it up as follows:

> The Board finds that appellee initiated the resignation and got what he bargained for in exchange—a clear record, his WGI, no action with respect to removal for cause, and, continuation on the agency rolls for three months while he searched for other employment. The agency did not deceive nor default.

"Whether a resignation is voluntary or involuntary is determined, not by the form of the action or terminology used, but rather by the true substance of the action, and by the circumstances that produced it. *Patterson* v. *United States*, 193 Ct. Cl. 750, 436 F. 2d 438 (1971); Federal Personnel Manual Supp. 752–1, Subch. S1–2. Here plaintiff had freedom of choice and ample time within which to decide what action to take with respect to resignation in exchange for the WGI, which exchange he initiated and understood. Plaintiff set the effective date of his resignation. In light of these facts, this transaction did not amount to an adverse action, so no occasion arose requiring provision of applicable procedural rights. *Christie* v. *United States*, 207 Ct. Cl. 333, 518 F. 2d 584 (1975); 5 C.F.R. §§ 752.201 *et seq.* (1971). HUD, moreover, committed no legal error in failing to advise plaintiff of his right to seek reconsideration of its judgment that his work was not of an acceptable level of competence, entailing the proposed denial of his WGI. *See* 5 U.S.C. § 5335 (1970); 5 C.F.R. § 531.407 (1971). Such notice of appeal rights need only be given an employee at some time before the end of his 'waiting period,' the amount of time that must lapse between the granting of WGI's. 5 C.F.R. § 531.407(c)(3) (1971). Plaintiff had submitted his resignation well before the expiration of his waiting period, presenting HUD with no need or opportunity to give him notice.

"ARB dismissed the charge that the approval of plaintiff's WGI by supervisors who thought that he did not merit it was illegal and invalidated the resignation that plaintiff submitted in exchange, saying that even if the WGI should

not have been granted as a part of the compromise package to obtain plaintiff's resignation, nevertheless it could not void an otherwise valid resignation. The validity of plaintiff's resignation depends upon its voluntariness, and again, that is determined from the circumstances surrounding it, not by mere forms and technicalities. Plaintiff initiated and controlled the resignation process, and received in exchange exactly what he bargained for. Plaintiff is estopped from challenging the validity of his resignation on this ground, having accepted the benefits of his own suggestion that he resign, which was agreed to and relied upon by defendant. *Peters* v. *United States*, 208 Ct. Cl. 373, 534 F. 2d 232 (1975); *Steuer* v. *United States*, 207 Ct. Cl. 282 (1975); *Weir* v. *United States*, 200 Ct. Cl. 501, 511, 474 F. 2d 617, 622, *cert. denied*, 414 U.S. 1066 (1973). The ARB decision is sustained.

"IT IS THEREFORE ORDERED that plaintiff's motion for summary judgment be and it is denied. Defendant's cross-motion for summary judgment is granted. The petition is dismissed."

Plaintiff's motion for rehearing or, in the alternative, for rehearing *en banc* was denied April 29, 1977. On August 27, 1977 plaintiff filed a petition for a writ of certiorari.

No. 98-75. FEBRUARY 4, 1977

Northrop Carolina, Inc.

Contracts; default termination; substantial evidence.—Plaintiff contracted with the Navy Ships Parts Control Center to supply aircraft parachute flares. The contract was default terminated for failure to supply the items within the period specified in the contract. Plaintiff seeks Wunderlich Act review of a decision of the Armed Services Board of Contract Appeals, affirmed on reconsideration, sustaining the default termination, and also seeks to have the court convert the termination into a termination for the convenience of the Government. On August 6, 1976 Trial Judge Thomas J. Lydon filed a recommended decision (reported in full at 22 CCF para. 80535) holding that the conclusion of the Board that plaintiff's contract was

properly terminated for default is supported by substantial evidence and is otherwise correct as a matter of law. On February 4, 1977 the court affirmed and adopted the said decision as the basis for its judgment in this case, ordered that plaintiff is not entitled to recover, and dismissed the petition.

No. 135-75. FEBRUARY 4, 1977

Curvin J. Trone, Jr., Trustee for
Westgate-California Corp., etc.
et al.

Taking; actions by Federal agencies within regulatory authority to redress improper financial activities.—On February 4, 1977 the court entered the following order:

George Miron for plaintiffs; *Henry Huntington Rossbacher*, attorney of record. *Wyman, Bautzer, Rothman & Kuchel, Frank Rothman, James R. Andrews, Barry E. Fink* and *Allan C. Lebow*, of counsel.

Peter A.T. Sartin, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Ray Goddard, Dorothy S. Kulig* and *Lise S. Haupt*, of counsel.

Before DAVIS, *Judge*, Presiding, and KASHIWA, *Judge*.

"This case comes before the court on defendant's motion for summary judgment founded on the grounds that no claim is stated which is within this court's jurisdiction and that the petition fails to state any claim upon which relief may be granted. Oral argument has been had and the court has considered the briefs and exhibits of the parties.

"Plaintiffs are (1) trustees in bankruptcy appointed for several corporations (including Westgate-California Corporation) which formed part of C. Arnholt Smith's financial empire, and (2) several corporations subsidiary either to Westgate-California or to subsidiaries of Westgate-California.[1] The gist of their claim is that the United States took property of theirs, without paying just compensation, by

[1] For convenience we shall sometimes refer collectively to the trustees and the suing corporations as "the plaintiff companies."

virtue of actions required to be taken by them (through C. Arnholt Smith as intermediary) in connection with the difficulties of the United States National Bank of San Diego (the Bank) which likewise was a component of Smith's financial empire and was likewise controlled by him. In October 1973 the Comptroller of the Currency declared the Bank to be insolvent; the Federal Deposit Insurance Corporation (FDIC) was duly appointed receiver. Before that time the Bank, at Smith's instance, had made loans and had other transactions, directly or indirectly, with the plaintiff companies. Without going into the complex details, we take the pith of the present claim to be that, both before and for some time after the open declaration of insolvency, the Comptroller and other federal agencies put pressure on Smith (in his capacity as chief owner of the Bank) to take action with respect to these companies (which he also controlled) which caused them to incur losses, directly or indirectly, with respect to dealings with the Bank, *i.e.*, caused them to pay debts owed the Bank sooner than anticipated, caused them to give the Bank allegedly low rental rates, caused the Bank to refuse further loans or extensions of credit to them, caused the Bank to require security for unsecured or improper secured loans, caused the Bank to preserve and protect its interest in collateral securing loans involving the plaintiff companies, etc.

"In the first of their papers filed with this court, plaintiffs seemed to assert that the Comptroller and other federal agencies had acted wrongfully, negligently and in abuse of their power and discretion in taking the various actions now complained of by the plaintiff companies. Such claims sound in tort and would clearly be outside our jurisdiction. *Eastport Steamship Corp. v. United States*, 178 Ct. Cl. 599, 372 F.2d 1002 (1967). However, plaintiffs have since made it perfectly clear that they do not challenge the propriety of any of the actions taken by these federal officials in connection with their regulation of and control over the Bank. Rather, plaintiffs' sole claim is that these actions, though deemed for the purposes of this case to be wholly authorized and proper conduct in trying to protect and preserve the operations and assets of the Bank,

nevertheless constituted a taking of the property of the complaining Smith-dominated companies.[2]

"This being the current posture of the case, we must uphold defendant's contention that plaintiffs have failed to state a viable claim for a taking requiring the payment of just compensation. As the case comes to the court, what we have before us is (a) a history of C. Arnholt Smith, as dominator of the Bank, causing that financial institution, before its difficulties brought the Comptroller of the Currency into the picture, to make improper, unsafe, and unsecured loans to several of the plaintiff companies (which he also dominated) and to give them unjustified preferential treatment—coupled with (b) an appropriate effort by the Comptroller of the Currency and by other federal agencies (once they intervened) to rectify that situation by refusing thereafter to make such improper or unsafe loans or to grant extensions of credit, and also by putting pressure on Smith to cause plaintiff companies to give proper security, or to repay improper, unsafe, or unsecured loans, or otherwise to compel plaintiff companies to give up the improper advantages they had obtained from the Bank through Smith. This amounts to no more than customary regulation by the banking authorities of a troubled bank in an attempt to put its affairs in correct order and to undo and untangle prior actions of the Bank which should not have been undertaken. The United States did not get any of the assets of the plaintiff companies for itself[3] nor did it receive any benefit other than through the potential improvement of the banking system in the attempt to save the United States National Bank. The Government simply caused the plaintiff companies to do what they should have been required to do by a properly-run Bank.

"Sometimes governmental regulation is so drastic that a constitutional taking necessarily results. *See, e.g., Pennsylvania Coal Co. v. Mahon,* 260 U.S. 393 (1922); *United States*

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[2] *I.e., formerly* Smith dominated.

[3] Insofar as the FDIC, as receiver of the Bank, may have received assets and property on behalf of the Bank for which the plaintiff companies had a claim, they do not pursue such claims in the present litigation. They have for the most part settled and released their claims against FDIC.

v. Central Eureka Mining Co., 357 U.S. 155, 168 (1958); *Benenson v. United States*, 212 Ct. Cl. 375, 548 F. 2d 939 (1977). But this is clearly not such a case. The actions taken and directed by the Comptroller of the Currency and the other federal officials fell well within the ambit of conventional bank regulation by governmental authorities. *Cf. Eastport Steamship Corp. v. United States, supra*, 178 Ct. Cl. 599, 612, 372 F.2d 1002, 1011–12 (1967). Insofar as plaintiff companies were caused to give up property or assets, that was a direct result of the improper preferential position, *vis-à-vis* the Bank, the main plaintiff companies had previously obtained through the intervention of C. Arnholt Smith whose conflict-of-interest spot had enabled and caused them to receive undue advantages to which they were not entitled. Plaintiffs wish to appear now as if they were wholly innocent at all the relevant times—free of and separate from the Smith taint. That is of course not true. In regulating the Bank's operations, the federal officials had the right to consider plaintiff companies as having been placed in their unfair preferential position by Smith, who dominated and controlled them as well as the Bank, and these officers had the right to try to rectify those improper advantages by requiring the companies, through Smith, to put themselves in the correct stance *vis-à-vis* the Bank. If Smith's manipulations in obtaining improper preferences for the companies caused injury to them (or their affiliates) in the long run, plaintiffs may well have a claim against Smith. They cannot, however, shift that demand to the Government which they concede acted lawfully and properly in moving to neutralize, so far as the Bank was concerned, the unfortunate and preferential results of the Smith conflict-of-interest taint.

"We have ruled that the United States cannot be held liable under the Tucker Act for commercial injuries resulting from a failure or wrong in the course of the normal regulatory process. *Eastport Steamship Corp. v. United States, supra*, 178 Ct. Cl. 599, 608–11, 372 F.2d 1002, 1009–1011 (1967). *A fortiori* the same principle must apply when the federal officials have committed no such wrong in the regulatory process but have merely tried to redress failures or improper activity by business entities through

compulsion on those persons to comply with the proper standards.

"The Regional Rail Reorganization Act Cases, 419 U.S. 102, 125–56 (1974), on which plaintiffs rely, were quite different. There the statute provided for the compulsory transfer under a Final System Plan to Consolidated Rail Corporation (in return for Conrail securities and other obligations and benefits) of designated rail properties by certain railroads in reorganization ('conveyance taking'), and also mandated that these companies remain in operation, at a loss if need be, to the extent necessary for these assets to be available for transfer ('erosion taking'). These actions required by the Reorganization Act (*i.e.* forcing the claimant to hand over its assets to another entity at what might be less than constitutionally-required fair value, and compelling a company to stay in business even though it continued to suffer large losses) lie in the traditional mold of potential eminent domain takings of private property—not in the pattern, as here, of governmental regulation correcting and redressing substandard and improper activities by private persons which have hurt others (here the Bank, its depositors, and its other creditors). Plaintiff companies are not like the railroads affected by the Regional Rail Reorganization Act; rather, they are like persons who have gained from a fraud and who are then obliged to disgorge their improper benefits.

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's motion for summary judgment is granted and the petition is dismissed."

On May 5, 1977 plaintiffs filed a petition for writ of certiorari.

No. 354–75. FEBRUARY 4, 1977

J. C. Byrnes

Civilian pay; dismissal; finality of arbitrator's findings and recommendations; Civil Service Commission decision; Court of Claims scope of review; penalty v. offense; Internal Revenue Service employee.—On February 4, 1977 the court entered the following order:

John F. Bufe, for plaintiff. *Robert M. Tobias,* plaintiff's attorney of record.

Arlene Fine, with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Before COWEN, *Chief Judge,* DAVIS and BENNETT, *Judges.*

"This case comes before the court on the parties' cross motions for summary judgment. After hearing oral argument, the court has considered the briefs, exhibits and argument and finds that there are no disputed issues of material facts which require trial. Therefore, the case can be disposed of on the motions and the administrative record.

"Plaintiff, who had been employed as a Revenue Officer for the Internal Revenue Service was dismissed from his position on two charges: (1) that he submitted a false travel voucher and (2) that he made a false statement concerning a matter of official interest in that he subsequently affirmed the correctness of the false voucher when questioned by his superior. Plaintiff's discharge became effective January 19, 1973. Pursuant to the Multidistrict Agreement entered into between the Internal Revenue Service and the National Treasury Employees Union, plaintiff elected to challenge the discharge by invoking advisory arbitration rather than the regular agency appeal procedure. The agreement provided that the decision of the arbitrator would be advisory in nature and would be limited to a recommendation that the agency decision be affirmed, mitigated, or reversed. After holding a hearing, at which plaintiff and other witnesses testified, the arbitrator rendered a decision in which he held that the Government had the burden of proving by substantial evidence that plaintiff had knowingly falsified his travel voucher and had knowingly made a false statement in affirming its correctness. The arbitrator then found that the evidence had not been substantial enough to remove doubts regarding plaintiff's guilt; resolved the doubts in favor of plaintiff, and concluded that the decision to separate him was not in the best interest of the Internal Revenue Service (IRS). Accordingly, he recommended that

the decision of the IRS should be reversed. The arbitrator's recommendation was rejected by the IRS which sustained the discharge. Plaintiff's subsequent appeals to the Federal Employees Appeal Authority and to the Appeals Review Board of the Civil Service Commission, proved fruitless as both agencies affirmed the decision of the IRS.

"We find this a very close and difficult case. If we had heard the relevant evidence in an open court trial, we might have reached a different result. However, our function as a reviewing court is limited and we must uphold the decision of the Civil Service Commission if we find that it, rather than the decision of the arbitrator, is supported by substantial evidence. *Peters* v. *United States*, 187 Ct. Cl. 63, 408 F.2d 719 (1969) and *Jacobowitz* v. *United States*, 191 Ct. Cl. 444, 424 F.2d 555 (1970).

"The decisions of the arbitrator and the Civil Service Commission rested largely upon their conflicting assessments of whether the Government had sustained its burden of proving that plaintiff had deliberately falsified. The administrative decisions rejecting the arbitrator's recommendation should have contained more explicit statements of the reasons for such action, but we think they sufficiently explain the rationale for the result reached.

"The first question to be resolved by us is the weight to be accorded the arbitrator's findings and recommendation. We think that the arbitrator's status was the same as that of an agency hearing examiner who renders advisory decisions. On judicial review, the arbitrator's decision in this case is not entitled to the finality that is accorded the decision of an arbitrator who is authorized, pursuant to a collective bargaining agreement, to resolve all disputes arising under the agreement. Plaintiff's reliance on such cases as *United Steel Workers* v. *Warrior & Gulf Co.*, 363 U.S. 574 (1960), and *Amalgamated Meat C. & B., L. 540* v. *Neuhoff Bros. Pack., Inc.*, 481 F.2d 817 (5th Cir. 1973), is misplaced. Moreover, the arbitrator's findings are not as unassailable as a master's and may be reversed by the Commission even when such findings are not clearly erroneous. *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 492 (1951). It is 'the agency's function, not the Examiner's,

to make the findings of fact and select the ultimate decision.' *Greater Boston Television Corp.* v. *F.C.C.*, 444 F.2d 841, 853 (D.C. Cir. 1970), *cert. denied*, 403 U.S. 923 (1971). Where there is substantial evidence supporting the examiner's decision and also the agency's decision, the agency's decision governs on all questions, including the credibility of witnesses. Of course, the examiner's report must be taken into account, but it is entitled to only such force as it intrinsically commands. *Universal Camera Corp.* v. *NLRB, supra;* K. DAVIS, ADMINISTRATIVE LAW TREATISE, sec. 10.04, p. 222 (1954); *Lorain Journal Co.* v. *F.C.C.*, 351 F.2d 824 (D.C. Cir. 1965).

"In applying these legal principles to the record before us, we have, with some difficulty, concluded that the administrative decisions are supported by substantial evidence. Although there is substantial evidence to support the findings and conclusion of the arbitrator, we find that the following constitutes substantial evidence which is sufficient to uphold the decisions of the Commission to the contrary:

"1. The arbitrator found that in a prior adverse action, effective June 11, 1972, plaintiff was notified of a reduction in his grade and pay on the grounds that he had forged the signature of a taxpayer to an agreement for the liquidation of delinquent taxes. Thereafter, on three occasions, plaintiff stated (once under oath) that the taxpayer had signed the form. By affidavit, plaintiff recanted his previous statements and admitted the forgery. He initially appealed the reduction in grade and pay, but later dropped the appeal. The arbitrator found that the conduct upon which the prior adverse action was based was similar to the alleged misconduct involved in the present case.

"2. On October 4, 1972, as the arbitrator found, plaintiff submitted an affidavit in which he stated that his travel voucher was based in part upon a telephone conversation with a motel clerk, but in plaintiff's testimony before the arbitrator, no reference was made to a telephone call to the motel to check on the rates charged him.

"3. The arbitrator found that some of the testimony which plaintiff gave at the hearing before him was inconsistent with statements made by plaintiff's attorney

during an oral reply to the charges. The arbitrator stated that he believed the attorney had received such contrary information from the plaintiff.

"4. The arbitrator found that plaintiff had a good memory for some events which occurred many months before, but claimed to be forgetful on other events. In that connection, the Commission's decision called attention to the fact that plaintiff was able to recall his exact expenditures for motel room rentals on August 2, 1972 and August 29, 1972, but could not recall what he paid for the night of August 10, 1972.

"5. The arbitrator also stated that he had doubts as to whether plaintiff had been entirely honest in the controversy and also had doubts as to whether plaintiff had knowingly falsified the travel voucher and knowingly made a false statement in affirming it. He did not state affirmatively that he believed plaintiff's testimony or that he found him credible. The arbitrator simply held that the defendant had failed to remove doubts concerning plaintiff's guilt.

"From our study of the arbitrator's decision, we recognize that there is substantial evidence which supports his conclusion. Such evidence, in addition to plaintiff's testimony, includes the fact that plaintiff's travel voucher was prepared late and hurriedly; that the motel where he stayed had been renovated and had raised its rates for some rooms during the period in question; that plaintiff was of a forgetful nature, often leaving the motel without paying his bill; that he forgot to pay his August 10, 1972 bill, and that in the conversation with his superior when he affirmed the correctness of his travel voucher, he did not realize why he was questioned and was not told that the Inspection Service had prompted the inquiry, and that the District Director of Internal Revenue had been notified about plaintiff's travel voucher. Nevertheless, as we have stated, where the evidence supporting the agency's finding is substantial even though its conclusion is contrary to that of a hearing examiner whose findings are likewise supported by substantial evidence, the decision of the agency must be upheld.

"In his reply brief plaintiff also contends, as he had alleged in his petition, that the penalty of removal in this case was so disproportionate to the offense that it constituted an abuse of discretion. Plaintiff relies primarily on *Power* v. *United States*, 209 Ct. Cl. 126, 531 F.2d 505 (1976). If the facts of this case were similar to those before the court in *Power*, we would reach the same result because of the de minimis nature of the charges against plaintiff. Unfortunately for plaintiff, however, the resemblance between *Power* and this case stops with the de minimis nature of the charges. In *Power*, the plaintiff had an unblemished record of 25 years' Government service and the Government failed to establish that plaintiff had failed to collect an unauthorized amount on the items involved in the major charge against him. The court also found that there was some doubt that plaintiff actually submitted false information and that on some of the expense claims, there was no loss to the Government.

"By contrast, it was less than 6 months before the charges now in issue were made against plaintiff that he was demoted in both grade and pay because of falsification of an official document and subsequent false statements which he made regarding it. As recited in the arbitrator's decision, Section S4–3b of the Federal Personnel Manual provides that when the employee has been subjected to disciplinary action for one or more past offenses, the agency may use that disciplinary record as part of the basis for a current adverse action against him, provided certain criteria are met. The criteria were met here, and the arbitrator found that the misconduct there was similar to that in the present case. Therefore, he held there was a valid reason for the agency to rely on it in support of the charges at issue in the hearing before him. In that connection, he stated:

> Moreover, the employer would not be precluded from taking more severe disciplinary action in the present case although it would involve a lesser offense.

In view of all these circumstances, we conclude that the penalty assessed was not an abuse of the defendant's discretion. *See Birnholz* v. *United States*, 199 Ct. Cl. 532 (1972).

"IT IS THEREFORE ORDERED that plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted and the petition is dismissed."

No. 395–75. FEBRUARY 4, 1977

COAC, Inc.

Contracts; disputes; claim arising under contract; Suspension of Work Clause; delayed notice to proceed with performance; proof of damages; timely pleading of issues.— On February 4, 1977 the court entered the following order:

Robert A. Belluomini, attorney of record, for plaintiff. *Robert N. Katz*, of counsel.

Stephen G. Anderson, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, *Judge*, Presiding, and KASHIWA and KUNZIG, *Judges*.

"This case comes before the court on plaintiff's request for review of Trial Judge George Willi's opinion and recommended decision [reported at 22 CCF para. 80023] on defendant's motion to dismiss (treated by the trial judge as a motion to dismiss for failure to state a claim on which relief can be granted).[1] The trial judge recommended that the petition be dismissed. Oral argument has been had and the court has considered the briefs of the parties. Further materials have been received and accordingly the court deems the defendant's motion to be one for summary judgment. We agree that the petition should be dismissed.

"Plaintiff identifies itself as a California building contractor who, as low bidder, was awarded an estimated $319,982 contract on June 28, 1971, by the U.S. Department of Interior for the construction of three sewage pumping stations in Yosemite National Park, California.

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[1] Plaintiff has also filed a motion for leave to file an amended petition which is likewise before us.

The contract allotted 180 days from receipt of the notice to proceed for completion of the work.[2]

"Plaintiff avers that the notice to proceed was not issued until August 16, 1971, with the result that it was obliged to perform its work in colder and more inclement winter weather than would have been the case had the notice been issued more promptly after the June 28 award. Thus, plaintiff alleges that defendant breached the contract by unreasonably delaying issuance of the notice to proceed and is therefore liable to it in damages sufficient to compensate for the added cost of performing the work in unfavorable weather conditions.

"The petition goes on to recite that plaintiff unsuccessfully sought an equitable adjustment[3] from the contracting officer on the above account and thereafter appealed the latter's adverse decision to the Interior Board of Contract Appeals (Board) with a similar lack of success. Neither party asked for an evidentiary hearing and the case was submitted to the Board on a paper record. The Board's initial decision was rendered December 6, 1974. *COAC, INC.*, 74–2 BCA ¶ 10,982. On the matter of delay the Board pointed out that because the contract included a standard form of Suspension of Work clause, the contracting officer erred when he denied plaintiff's equitable adjustment claim on the ground that the contract provided no redress for unreasonable delay in issuing a notice to proceed. Although plaintiff had literally predicated its claim on the Changes and Changed Conditions clauses, the Board treated it as filed under the Suspension of Work clause. On the merits of the delay question, the Board charted the occurrences between June 28, 1971, the award date, and August 16, 1971, the date of issuance of the notice to proceed. Among those events, which included the interposition of a formal protest by the actual low bidder (a protest that was formally disallowed on August 12, 1971 because

[2] In fact, plaintiff was ultimately allowed approximately 465 days for performance. Much of that time was consumed in rectifying the structural defects that caused all three stations to be initially rejected for faulty workmanship.

[3] Whereas the equitable adjustment sought at the administrative level for delay in issuance of the notice to proceed was for $34,197.12, the damages requested in the present suit for the same delay amount to $125,000 of which $75,000 is represented as direct cost. No explanation for the discrepancy in the figures appears.

the bid was deemed untimely), was the fact that it was not until July 15, 1971 that plaintiff delivered the necessary performance and payment bonds to the Government. Punctuality of the notice to proceed was to be measured from that date, the Board held. It therefore concluded that, intervening protest considerations notwithstanding, there may well have been unreasonable delay in failing to get out the notice to proceed within five working days of July 15. The Board then held, however, that it was unnecessary to determine the precise interval of unreasonable delay because the plaintiff had totally failed to establish increased resultant cost. The decision explained (74–2 BCA at 52,262):

> A prerequisite to recovery of additional costs for working in the winter in a case like the present one is a showing that the initial delay caused or at least contributed to the work being carried over to the winter months. Since the record does not show the date COAC commenced prosecution of the work and does not show the scheduled times for various operations and the dates these operations were started and completed, it is evident that no such showing has been made in the instant case. We may not assume that COAC prosecuted the work with such diligence that there were no intervening delays for which it was responsible. It is also apparent that costs have been asserted in a most summary fashion upon the basis of a 60-day delay when the actual delay is less than one-half of that time span. Under these circumstances, the amounts claimed are little more than unsupported assertions or conclusion which may not be accepted as proof. The claim for increased costs due to the delay in issuance of the notice to proceed is denied.
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> * * * * *

"Following the above decision plaintiff returned to the Board with a request (received December 31, 1974) that the record there be reopened to permit it to present the type of evidence alluded to in the above-quoted portion of the original decision. In a further decision of February 19, 1975, the Board considered plaintiff's application and denied it for lack of a showing of justifiable excuse for

failure to offer the contemplated evidence (or any evidence at all) at the original proceeding. *COAC, INC.*, 75–1 BCA ¶ 11,104.

"Before the trial judge of this court the plaintiff insisted that its claim here was not 'under' the contract but rather for breach, that therefore the Board proceedings and decision could be disregarded, and that plaintiff was entitled to a trial in this court. The trial judge correctly rejected those contentions since the contract contained the standard Disputes and Suspension of Work clauses. The matter thus came directly within the province of the Board of Contract Appeals, including the quantum of recovery, and review here would only be under the standards of the Wunderlich Act. *See United States v. Utah Constr. Co.*, 384 U.S. 394, 415–16 (1966); *United States v. Anthony Grace & Sons*, 384 U.S. 424, 430 nn. 5 and 6 (1966).

"Before us the plaintiff has also stressed the point that the Board acted arbitrarily and capriciously, first, in refusing to find damage on the contractor's original presentation, and, second, in refusing to reopen the proceedings to allow COAC to present proof of damages. From the new materials relating to damages which have been proffered to us, we assume without deciding that, if that evidence had been presented to the Board, plaintiff would have made a prima facie case that substantial damages had been incurred.

"Nevertheless we cannot fault the Board for the actions it took. Presented in its original consideration with absolutely no proof of actual damage, the Board could properly refuse to find that any actual injury had been shown. The unreasonable delay was only about three weeks long and there is no inevitability or even high probability that a delay of that relatively short duration would necessarily occasion extra costs.

"And when plaintiff sought reopening from the Board it said conclusorily that testimony and evidence as to damage was readily available for presentation at any evidentiary hearing, but plaintiff did not specify in any way what that testimony and evidence consisted of.[4] The Board's decision

[4] It is significant, too, that the motion for reconsideration said that in its original decision the Board "appropriately" indicated that certain testimony and evidence

on reconsideration pointed out that plaintiff had had a considerable time in which to submit such damage evidence before the original decision was rendered but had not done so, that the motion for reconsideration did not contain anything showing that the additional evidence would likely produce a different result, and that 'the losing party should not lightly be given a second opportunity to prove his case.'[5] Plaintiff now claims financial stringency for the failure to make or proffer proof of damages before the Board but no such excuse was offered to the Board either on the original presentation or on the attempt to reopen.

"We cannot say that in the circumstances the Board abused its discretion or acted capriciously when it refused to reopen the case. The essential point is that the Board could properly find that the plaintiff failed at the appropriate times to make its case on damages. It is too late now to make up for that unexcused failure.

"There is one additional matter. In an amended petition attached to its request for review plaintiff alleges that it was coerced into performing certain uncompensated repair work that was necessary (*see* note 2, *supra*). This claim was unsuccessfully pursued at the administrative level but was not timely raised before the trial judge. We think it is too late to raise it now after the trial judge has rendered his decision. In any event, the Board found as a fact that plaintiff had failed to sustain its claim of duress.[6] This claim for an equitable adjustment for extra work said to have been forced on the contractor plainly arose 'under the contract' and was properly before the Board which could decide factual issues (including those relating to duress) involved in that claim. Plaintiff now challenges the Board's factual finding that there was no evidence before it of

was lacking in the record.

[5] In its motion for reconsideration, plaintiff's then counsel referred to the extended hospitalization of a member of his immediate family. The Board responded: "If extended hospitalization of a member of counsel's immediate family affected the handling of the case, the matter should have been brought to the Board's attention before the record was closed by letter, telegram or telephone."

[6] "* * * there is no evidence that termination for default was even so much as mentioned to COAC. [footnote omitted] Also absent from the record is any evidence of threats to assess liquidated damages and any evidence of actual or threatened improper withholdings of moneys due COAC."

threats to assess liquidated damages by producing a letter which it says constituted such a threat. But this letter, if relevant, does not appear to have been before the Board. Again plaintiff seeks too late to shore up a case which should have been, but was not, submitted at the administrative stage.

"IT IS THEREFORE ORDERED AND CONCLUDED THAT defendant's motion to dismiss (treated as a motion for summary judgment) is granted, plaintiff's motion for leave to amend its petition is denied, and the petition is dismissed."

No. 66-76. FEBRUARY 4, 1977

Antonio L. Guido

Military pay; correction of military records; what constitutes arbitrary and capricious refusal to correct.—On February 4, 1977 the court entered the following order:

Eric A. Seitz, attorney of record, for plaintiff.

Marc J. Fink, with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Before DAVIS, *Judge,* Presiding, KASHIWA, and KUNZIG, *Judges.*

"This case comes before the court on cross-motions for summary judgment. Plaintiff, a marine for fifteen years, was honorably discharged from the Marine Corps for the convenience of the Government. He later received a fifty percent disability rating from the Veterans Administration (VA) for service-related disabilities. Plaintiff then applied to the Board of Corrections of Naval Records (BCNR) for *military* disability pay, alleging his records were in error. He claimed he had been discharged from the service without having been given the required physical examination. Plaintiff's request was considered through various appropriate departmental evaluation offices and eventually denied by the BCNR on April 23, 1975. This suit followed on February 23, 1976.

"Plaintiff's principal argument revolves around the defendant's failure to give him a physical examination at

separation, allegedly violating Marine Corps Manual § 7006. The Government responds that the BCNR action was in no way arbitrary and capricious and was supported by substantial evidence.

"The sole question before the court is whether the BCNR was in any way arbitrary and capricious. Plaintiff's attorney conceded in open court that had plaintiff been given a physical at separation, he would have no case. The BCNR carefully considered the VA's rating, a report from the Bureau of Medicine & Surgery, Department of the Navy, and plaintiff's medical and personnel files, and found a VA physical conducted only six weeks after plaintiff's discharge stood in lieu of a discharge physical. The BCNR further found the VA physical contained no evidence of a condition that would have rendered plaintiff unfit for military service. If failure to give a discharge physical was error, it was surely harmless error under the circumstances of this case. *See, e.g., Murphy* v. *United States*, 209 Ct.Cl. 352 (1976).

"Further, the BCNR's failure to give plaintiff copies of the Physical Evaluation Board's and the Physical Review Council's advisory opinions was not reversible error in this case. These advisory opinions were mere summary conclusions adding nothing to the information already available to plaintiff and the BCNR's actions do not come within those proscribed by the court in *Hutter v. United States*, 170 Ct.Cl. 517, 345 F.2d 828 (1965).

"We can find no evidence that the BCNR acted in any arbitrarily and capriciously manner as these terms have been defined by the court. *E.g., Storey v. United States*, 209 Ct.Cl. 174, 531 F.2d 985 (1976); *Williams v. United States*, 186 Ct.Cl. 611, 405 F.2d 890, *cert. denied*, 396 U.S. 966 (1969). Therefore, the decision of the BCNR is final and binding. *Unterberg v. United States*, 188 Ct.Cl. 994, 412 F.2d 1341 (1969).

"Accordingly, upon consideration of the pleadings, plaintiff's motion for summary judgment, defendant's cross-motion for summary judgment, and the briefs and representations of the parties, and after oral argument, IT IS ORDERED that defendant's cross-motion for summary

judgment be granted, plaintiff's motion for summary judgment be denied, and the petition dismissed."

Plaintiff's motion for rehearing and reconsideration was denied April 1, 1977.

No. 185–76. FEBRUARY 4, 1977

Gerald J. Miatech

Civilian pay; reduction-in-force; failure to exhaust administrative remedies; right to pre-termination hearing—On February 4, 1977 the court entered the following order:

A. Roger Jeanson, attorney of record, for plaintiff.

Ray Goddard, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges*.

"This civilian pay case is before the court on cross-motions for summary judgment. Upon consideration of the motions and briefs of the parties and after hearing oral argument, the court holds for the Government and dismisses the petition.

"Plaintiff is a former GS–15 space scientist at National Aeronautics and Space Administration (NASA) Ames Research Center, separated from his employment pursuant to a reduction-in-force (RIF). He argues principally that his removal was a retaliation action (bad faith), that he should have been afforded a full evidentiary hearing and that the decision of the tribunal below was arbitrary and capricious.

"The Government counters that his retaliation argument was never raised below, that a full hearing is not required in a RIF case, and that the decision below was not arbitrary, capricious or in violation of law.

"Plaintiff argued his position on 'bumping' rights through appropriate Civil Service tribunals to the Board of Appeals and Review (BAR). All decided against him. He then filed suit in the U.S. District Court (N.D. Calif.), which transferred the case to this court pursuant to 28 U.S.C. § 1406(c) (1970).

"We find that plaintiff did not raise his 'retaliation firing' argument below. Failure to present an issue before the BAR amounts to failure by plaintiff to exhaust his administrative remedy on that question and precludes plaintiff from suddenly now attempting to argue before this court for the first time: 'They were out to get me.' *Roski* v. *United States*, 204 Ct.Cl. 40, 48 (1974); *Haynes* v. *United States*, 190 Ct.Cl. 9, 12, 418 F.2d 1380, 1382 (1969). Secondly, plaintiff is not entitled to a full evidentiary hearing. The Government urges that NASA was routinely abolishing the Planetary Environment Branch (plaintiff's assignment) and this was the most ordinary and typical of RIF situations. We find no statute or regulation which requires a full evidentiary pre-termination hearing in a RIF separation. *Rasmussen* v. *United States*, 211 Ct. Cl. 260, 267, 543 F.2d 134, 137 (1976); *Terry* v. *United States*, 204 Ct.Cl. 543, 449 F.2d 695 (1974), *cert. denied*, 421 U.S. 912 (1975). *See Fitzgerald* v. *Hampton*, 467 F.2d 755, 758–60 (D.C. Cir.), *stayed pending filing of cert. petition*, 409 U.S. 1055 (1972), *stay dissolved*, 409 U.S. 1100 (1973). (In addition, plaintiff never *asked* for a hearing before the CSC.)

"Finally, the decision as to what qualifications are necessary for various and sundry Government positions is committed to the discretion of the agency. *Wilmot* v. *United States*, 205 Ct.Cl. 666, 682 (1974); *Albert* v. *United States*, 194 Ct.Cl.95, 100–02, 437 F.2d 976, 978–79 (1971); *Greenway* v. *United States*, 175 Ct.Cl. 350, 354, *cert. denied*, 385 U.S. 881 (1966). We find no evidence of abuse of administrative discretion. Plaintiff has failed to show that the decision of the BAR was in any way arbitrary or capricious or not supported by substantial evidence.

"Plaintiff also raises certain minor issues which we find without merit and deserving of no further comment.

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is granted, plaintiff's cross-motion for summary judgment is denied, and the petition is dismissed."

No. 261–76. FEBRUARY 4, 1977

David Spiegel

Judgments; former adjudication; parties and their privies; application for Government employment; constitutionality of loyalty questions.—On February 4, 1977 the court entered the following order:

Marshall W. Krause, attorney of record, for plaintiff. *Krause, Baskin & Shell,* of counsel.

Marc J. Fink, with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Before DAVIS, *Judge,* Presiding, and KASHIWA and KUNZIG, *Judges.*

"We are asked by the Government to give summary judgment against the plaintiff. Oral argument has been presented and we have taken account of the written submissions of both parties. We grant the defendant's motion for the reasons about to be given.

"We take the following facts to be agreed upon by the parties for present purposes:—In June 1975 Dr. Spiegel, a psychiatrist, submitted an application for employment by the Veterans Administration (VA) at its hospital in Palo Alto, California. He was told by the VA to report for duty on July 1, 1975, at which time he would have to fill out the necessary employment forms. He did report on July 1st and filled out the appropriate forms except that he declined to answer certain 'loyalty questions' on one of the forms. Completion of answers to these questions was required for employment at the VA hospital. Because of Dr. Spiegel's failure to answer these questions, the hospital administrators declined to appoint him or to put him on the payroll at that time (he was officially employed, as indicated below, on August 15, 1975). However, he was permitted in the period from July 1-August 15 to perform the regular psychiatric duties he performed after he was appointed (on August 15th), except that he was unable to sign charts or write prescriptions.

"Meanwhile a suit had been brought by other doctors in the United States District Court for the Northern District

of California, to have the VA 'loyalty questions' declared unconstitutional and to enjoin the agency from requiring them to be answered as a condition of employment. *Steven Oboler, M.D.*, et al v. *Robert H. Hampton*, et al., N.D. Calif., No. C–74–2265–OJC. On August 4, 1975, the District Court issued such a permanent injunction and held the questions to be violative of the First Amendment; as a result, the VA officially appointed plaintiff to a paying position at its VA hospital at Palo Alto on August 15, 1975.

"Thereafter the plaintiffs in the *Oboler* action, with Dr. Spiegel's active participation, moved to hold the defendants in that action (Government officials, including officials of the VA Palo Alto hospital) in contempt for failure to give back-pay to Dr. Spiegel, the present plaintiff. The *Oboler* defendants agreed to pay him from August 11th, the day when they received copies of the District Court injunction. The District Court held (on October 15, 1975) that August 11th was the correct date from which to pay Dr. Spiegel and denied the motion for an order holding the *Oboler* defendants in contempt. Reconsideration was denied on December 23, 1975. Dr. Spiegel has been paid since August 11th. His current suit, instituted June 28, 1976, is for pay for the period July 1-August 11, or in the alternative that he be paid the value of his services in quantum meruit.

"We hold that the present suit is precluded by the District Court's determination in the *Oboler* litigation, at the specific instance of Dr. Spiegel, that he is not entitled to compensation prior to August 11th. Plaintiff sought strenuously in that case to force the Government to pay him for the period from July 1 to August 11. The District Court held him not entitled to recover for that time, and its determination was on the merits, not for lack of jurisdiction.[1]

"This is the history of plaintiff's participation in *Oboler*:—Dr. Spiegel was not a party to *Oboler*, did not participate in the case before the court held the 'loyalty questions' invalid, and the District Court refused the *Oboler* plaintiffs' request to make it a class action covering all physicians employed by the Federal Government

[1] Both in the District Court and in this court the amount sought for Dr. Spiegel was and is less than $10,000.

(throughout the country) who desire to refrain from answering the 'loyalty questions' of the Civil Service Commission. But the court expressly made its injunction applicable to all Stanford University physicians seeking employment at the Palo Alto VA hospital in partial or full satisfaction of the conditions or requirements of their residency, internship or faculty position at Stanford University Medical School. By his own affidavit filed with the District Court Dr. Spiegel, an Acting Assistant Professor of Psychiatry at Stanford, asserted facts showing that he fell within this class—and the District Court so considered him in the proceedings about to be described.

"After the District Court had held the 'loyalty questions' invalid, Marshall W. Krause, Esq., counsel for the plaintiffs in *Oboler* and expressly appearing in this instance as Dr. Spiegel's attorney also,[2] sought in *Oboler* to hold officials of the Palo Alto hospital in contempt of the injunction for failing to pay Dr. Spiegel. It was in connection with this motion that Dr. Spiegel filed the affidavit referred to above, giving the facts as to the salary he alleges he was not paid. Apparently Dr. Spiegel also testified to the same effect at a hearing held by the District Court.

"The District Court rejected this motion, saying:

> The Court agrees that as of the date of filing of the August injunction its terms were enforceable. However, the parties have stipulated that defendants did not receive copies of the injunction until August 11, 1975. Thus any contempt order issued by the Court would be limited in coverage to the period of August 11—August 15, 1975. While plaintiffs contend that defendants were in contempt as of July 1, 1975, the Court is not persuaded. Dr. Spiegel was not a party to this action, and defendants did not receive the Court's Memorandum and Order declaring the loyalty oath questions unconstitutional until August 11. Thus it was not improper for defendants to refuse to process Dr. Speigel's employment papers for his failure to answer the questions until defendants had notice that the questions had been held unconstitutional. Thus Dr. Spiegel is not entitled to receive back salary for the

[2] His papers were signed in both capacities.

period of July 1—August 11, 1975. The court then proceeded to refuse a contempt order for the period August 11–15, in part because the Government officials had announced their willingness to pay plaintiff back salary from August 11 - August 15 (which they subsequently did).

"Mr. Krause, as attorney for the *Oboler* plaintiffs and also for Dr. Spiegel, sought reconsideration of that order. His motion complained that the court's order and memorandum in the contempt motion 'failed to deal with Doctor Spiegel's prayer for back pay during the time he was hired to work at the Veterans Administration Hospital, did actually work at the Veterans Administration Hospital, but was not on the payroll of the Veterans Administration Hospital solely because the defendants [Government officials] refused to process his papers for failure to execute answers to the loyalty questions which the court has now found that the defendants had no right to ask of Doctor Spiegel.' Counsel's memorandum then went on to insist that, even though the officials were not to be held in contempt, Dr. Spiegel was entitled to his back salary.[3]

"The District Court's answer (filed December 23, 1975), denying the motion for reconsideration, recited that it had held (in overruling the contempt motion) that 'Dr. David

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[3] Mr. Krause's memorandum contained the following:

However, it has always been assumed in these proceedings that any employee of the Veterans Administration who worked but was not paid solely because of failing to sign the unconstitutional loyalty questions would be paid for the period that he worked when and if the loyalty questions were held unconstitutional. That is exactly what has happened to Doctor Spiegel. The testimony before this court at the last hearing shows that he was hired beginning July 1, 1975, stopped all other employment as of July 1, 1975, reported for work at the Veterans Administration Hospital in Palo Alto on July 1, 1975, and did perform his job from July 1, 1975, (or at least as much of his job as the defendants in this action would allow him to perform) and yet has not been paid for this work. The only reason he was not paid was that he refused to do what the court has held to be unconstitutional for the defendants to require him to do. Not to pay him salary for this period would be to punish him for exercising his constitutional rights.

Although we disagree with the court's conclusion that the defendants should not be held in contempt for this period, this has nothing to do with the issue of whether Doctor Spiegel is entitled to his back salary for this period. As the court will recall, the other named plaintiffs in this action who were reinstated to their positions pursuant to the court's temporary restraining order, did receive their salary for this period until the determination could be made as to whether or not the loyalty questions were constitutional. Back pay is a normal incident of the court's ruling on the validity of the loyalty questions.

Spiegel is not entitled to receive salary for the period of July 1 - August 11, 1975,' and added that the court stood on its reasoning expressed in that memorandum and order, 'and concludes that Dr. Spiegel is not entitled to receive back salary.'

"On this record we are compelled to decide that Dr. Spiegel repeatedly sought to recover back salary in the *Oboler* litigation, and that the District Court twice denied that claim on its merits. In substance Dr. Spiegel's attorney (Mr. Krause) presented the same arguments as he does in this court, and those contentions were rejected as incorrect—not on the ground that the District Court had no right to consider them.[4]

"Plaintiff is bound by this determination because, though he was not formally a party to *Oboler* he deliberately inserted himself into that action and participated knowingly and actively (personally and through his attorney) in the phase of that litigation dealing with his back pay, seeking the same determination that he now asks from this court. The accepted rule is that a person who is not a party to an action but who controls or substantially participates in the control of the presentation on behalf of a party is bound by the determination of issues decided as though he were a party. ALI, Restatement of the Law Second, Judgments, Tent. Draft No. 2, § 83 (1975). Plaintiff fits squarely into that class since his own attorney,[5] with his consent and active participation, raised and pressed the issue of Dr. Spiegel's back pay. That question is precisely the same as the one in the present case. Plaintiff had both opportunity and incentive to litigate the issue in *Oboler*—and he did so to the hilt. Having lost there, he cannot try all over again to vindicate the very same claim in another suit in this court, any more than he would be permitted

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[4] The District Court obviously considered Dr. Spiegel covered by its injunction, once issued, and held him entitled to pay from August 11th (when the VA hospital officials received notice of the injunction) until August 15th (when plaintiff was formally appointed and placed on the payroll). The court refused back pay for the period July 1—August 11 because it believed, rightly or wrongly, that Dr. Spiegel was not entitled to any pay until the hospital administrators received word that the "loyalty questions" were unconstitutional and that they were required to appoint persons like Dr. Spiegel.

[5] Who was also attorney for the named *Oboler* plaintiffs.

now to file a new independent suit under the Tucker Act in the District Court for the Northern District of California.

"IT IS THEREFORE ORDERED AND CONCLUDED THAT defendant's motion for summary judgment is granted and the petition is dismissed."

Nos. 103–61; 104–61; 172–61. FEBRUARY 18, 1977

Karl H. Stell

Pleading and practice; relief from judgment of another court; "independent action"; former adjudication; collateral estoppel; limitation of actions.—On February 18, 1977 the court entered the following order:

Karl H. Stell, pro se.

Lynn J. Bush, with whom was *Acting Assistant Attorney General Irving Jaffe,* for defendant.

Before COWEN, *Chief Judge,* NICHOLS and KASHIWA, *Judges.*

"This plaintiff, acting pro se, has filed a new petition seeking to reopen what he calls a 'case' dismissed by the court without a hearing. He refers to three suits previously brought by him in this court, Nos. 103–61, 104–61, and 172–61, all of which were dismissed, the first in 1964, the second in 1962, and the third in 1961. Giving the petition the most expansive reading possible, we further conclude it petitions that the cases be reopened and relief from the various judgments given under Rule 152(b). Plaintiff seeks relief based, he says, on 'new evidence.' Defendant has naturally concluded that plaintiff seeks relief under Rule 152(b)(2); however, the petition alleges various grounds and not 'newly discovered evidence' alone. Defendant opposes the petition on the theory that a motion based on newly discovered evidence must be filed within a year after the judgment, order or proceeding was entered or taken. We conclude, however, that the petition is really in the nature of an 'independent action' such as is referred to in the latter part of Rule 152(b). The allegations in plaintiff's new petition relate to wrongful action by the Navy in removing

him from his GS–9 position in 1959, his former wife's criminal behavior that involved him in his difficulties, and illegal acts by the Maryland police and the County Sheriff's office. The following summarizes the former decisions:

"1. *No. 103–61.* We do not have the petition, answer or defendant's motion for summary judgment in this case, but it appears that on February 14, 1964, the court granted defendant's motion for summary judgment and thereby dismissed plaintiff's suit to recover damages, to be reinstated to his former Civil Service position, to be reinstated in the United States Naval Reserve and for other relief. The court's decision was based on the Third Circuit's decision in *United States* v. *Stello,* 316 F.2d 801 (1963) which upheld the district court's conviction of plaintiff (after trial by jury) of knowingly and willfully making false statements as to the wages plaintiff had earned after his discharge from his civilian job. The Civil Service had reinstated him and in his false statement, he concealed the fact that he had earned $3,000 after his discharge. The Court of Claims held that plaintiff's suit was collaterally estopped by this decision and sustained defendant's special plea in fraud, 164 Ct.Cl. 750 (1964). Plaintiff's petition for certiorari was denied October 12, 1964, 379 U.S. 857.

"2. *No. 104–61.* Plaintiff's petition in this case was filed March 20, 1961, to recover payments under the Soil Bank Act on the two farms which plaintiff owned. The Government filed a motion for summary judgment, which was granted on February 2, 1962, and the last action taken on this case was a denial of plaintiff's motion for rehearing entered March 2, 1962.

"3. *No. 172–61.* Plaintiff's petition in this case was filed May 4, 1961, to recover $1,945.71 representing income tax credits which plaintiff claims the Internal Revenue Service wrongfully disallowed with respect to the operation of his farm for the years 1955, 1956 and 1957. The defendant's motion for a more definite statement was allowed by the court, and upon plaintiff's failure to comply with the motion, the defendant filed a motion to dismiss, which the court granted on December 20, 1961. Plaintiff's motion to set aside the dismissal was denied March 2, 1962.

"The court considered the nature of its 'independent action' jurisdiction in *Carney* v. *United States*, 199 Ct. Cl. 160, 462 F.2d 1142 (1972). As stated in that case, we lack equity jurisdiction and therefore cannot normally reopen decisions of other courts which, if not reopened, would bar a suit here by *res judicata* or collateral estoppel. When as in *Andrade* v. *United States*, 202 Ct. Cl. 988, 485 F.2d 660 (1973), *cert. denied* 419 U.S. 831 (1974), the *Carney* restrictions are not applicable, other jurisdictional limitations, *e.g.*, statutes of limitations, remain for application. The court must have jurisdiction of the subject matter, supposing there is no former judgment. And, of course, the degree of unconscionability of the former judgment must be considerable. Mere error of fact or law will not suffice as a reason.

"Applying the *Carney* and *Andrade* analysis to the instant petition, we conclude as follows:

"1. In *No. 103–61*, the 1961 petition, so far as it sought relief we could grant, was a collateral attack on a district court criminal conviction. Even if the Order of February 14, 1964, is not a *res judicata* bar, we still lack jurisdiction to review the conviction, and therefore it must stand and bar plaintiff by collateral estoppel here. If the conviction was wrongful, plaintiff's remedy, if he has one, is in the district court.

"2. *No. 104–61*, to recover soil bank payments, was dismissed for lack of jurisdiction. Plaintiff does not allege anything to show that, but for *res judicata*, we would have jurisdiction to review denial of his soil bank payments.

"3. *No. 172–61* was to recover income tax refunds. It was pending for a short time in 1961, being dismissed on December 20 of that year. Even if limitations were tolled while that action was pending, they have now long since run. There is no allegation that plaintiff's cause of action was fraudulently concealed from him, nor does any other ground for tolling limitations appear.

"Accordingly, treating the instant petition as a new 'independent action,' under Rule 152(b), the most favorable possible treatment it can receive, we determine that it does not allege sufficient grounds to support jurisdiction to reopen any of the three former decisions referred to.

Accordingly, by this order and without oral argument, the defendant's objections are sustained and the petition is dismissed."

Plaintiff's motion for reconsideration with new facts was denied April 1, 1977.

No. 117–73. FEBRUARY 18, 1977

L.A.S. Enterprises, Inc.

Pleading and practice; discovery; production of documents; tax information —On February 18, 1977 the court entered the following order:

Joseph J. Lyman, attorney of record, for plaintiff.

James L. Malone III, with whom was *Acting Assistant Attorney General Myron C. Baum,* for defendant.

Before SKELTON, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This case is before the court on defendant's request for review, filed December 8, 1976, under Rule 53(c)(2)(ii), of Trial Judge Spector's order of October 19, 1976, allowing discovery of certain information on 119 third-party federal income tax returns. The suit was brought for refund of employment taxes paid by plaintiff on the earnings of 119 mechanics who plaintiff believes worked for it (putting up aluminum siding) as independent contractors rather than employees, thus exempting plaintiff from the need to withhold the taxes from their wages and pay them over to the Government. Plaintiff asked the trial judge to allow it to inspect the mechanics' tax returns, to determine whether they considered themselves self-employed or employees of plaintiff and others during the tax year, whether they paid any self-employment taxes, and where their earnings came from during the period. The trial judge allowed the discovery, noting that such had previously been permitted by the court in an order in *Farm & Home Alum. Products, Inc.* v. *United States,* 211 Ct. Cl. 291 (1976), that the policy of Congress as recently stated in the 1976 Tax Reform Act was not to the contrary where discovery of

information on returns is integral to resolution of tax suits, *see* section 1202(a), and that this court had emphasized the relevance and even the critical nature of the information sought by plaintiff in its opinion in *Illinois Tri-Seal Products, Inc.* v. *United States*, 173 Ct. Cl. 499, 502, 353 F. 2d 216, 218 (1965). However, he confined the discovery to that allowed in *Farm & Home*, to give plaintiff all that it needed without causing an unnecessary invasion of the mechanics' tax returns' confidentiality.

"We have fully dealt with this matter before in *Farm & Home* in a manner that supports what the trial judge did here. At first blush this case appears distinguishable from that one, for here defendant opposes any discovery of the returns at all, while in that case the order gives the impression that defendant was willing to disclose the information sought, although with the restrictions embodied in the order. However, defendant itself shows that the situations do not differ, for it points out that it also opposed all discovery of the returns in *Farm & Home*, only expressing agreement to make disclosure with limitations after it had failed in its total opposition. There is no good reason why the discovery permitted in that case should vary from what is allowed in this one. The court thought in *Farm & Home* that the third-parties' privacy rights would be adequately protected by the measures authorized in the order. Nothing in the law prohibits this limited discovery, including Treasury regulations and section 1202(a) of the 1976 Act.

"Defendant argues that two Trial Division orders and a recent renegotiation opinion by the court run counter to the trial judge's order. However, the order in *Beyer* v. *United States*, Ct. Cl. No. 386–74 (Oct. 5, 1976), denying the requested discovery, was apparently based on the untimeliness of the motion, being first presented shortly before trial was scheduled to begin. The order in *Cory Pools, Ltd.* v. *United States*, Ct. Cl. No. 169–75 (Dec. 1, 1976), while strongly questioning the relevance of the information sought to be discovered as well as its admissibility at trial, did not deny plaintiff's motion to produce the tax returns for inspection and copying, but required plaintiff to submit a further explanation of the relevance and anticipated use

of the matter requested to be discovered. Neither of these rulings is a bar to the trial judge's ruling here, nor more in point than the court's order in *Farm & Home.* In the renegotiation case, *Instrument Systems Corp.* v. *United States,* 212 Ct. Cl. 99, 546 F. 2d 357 (1976), court's restriction of discovery of commercial data on forms RB–1 and on third-party tax returns was partly based, it is true, on privacy considerations, but was largely and essentially grounded on the fact that the information sought to be discovered was already in the hands of the party with the burden of proof, the defendant. The latter is of course not the situation in the case at bar, and so *Instrument Systems Corp.* is inapposite to a resolution of the present issue.

"Although the trial judge's order did not spell out the protections and limitations he would place on discovery of the 119 mechanics' tax returns, he incorporated by reference the provisions in the *Farm & Home* order requiring defendant to give plaintiff a schedule showing whether each mechanic who filed a form 1040 or 1040SE for the relevant year listed plaintiff as a source of income, described himself as self-employed or the employee of someone, and paid a self-employment tax. The *Farm & Home* order also required defendant to deliver the third-parties' tax returns to the trial judge along with the schedule it prepared, so that he could ascertain *in camera* the accuracy of the information given to plaintiff. These same protections and limitations are well suited to the discovery in the present case, and the discovery as so limited should be allowed to go forward as ordered by the trial judge.

"IT IS THEREFORE ORDERED that defendant's request for review is granted but the request for relief therein is denied."

No. 140–75. FEBRUARY 18, 1977

Ottie W. Hodges

Military pay; discharge; correction of records to show physical disability retirement; finality of decision of Cor-

rection Board.—On February 18, 1977 the court entered the following order:

Ottie W. Hodges, pro se, for plaintiff.

John W. Showalter, with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Before SKELTON, *Judge,* Presiding, KUNZIG, and BENNETT, *Judges.*

"In this *pro se* military disability retirement pay case defendant, unopposed by plaintiff, moves for summary judgment on three separate grounds. First, the Government urges that the suit is barred by the six-year statute of limitations, 28 U.S.C. § 2501; second, that it is barred by laches; and finally, that the Army Board for Correction of Military Records' (ABCMR) denial of plaintiff's claim was proper. We hold for the Government and dismiss the petition since we find that the ABCMR properly denied plaintiff's claim.

"Plaintiff, Ottie W. Hodges, was injured in a vehicular accident on November 17, 1961 while serving in the Army. On March 20, 1962, plaintiff's Commanding Officer recommended his removal from the service with an undesirable discharge (for unfitness). The discharge was approved, but was changed to a general discharge under honorable conditions, and was effectuated April 17, 1962, after plaintiff completed the mandatory physical and mental examination successfully. Plaintiff concurred in the physical examination report by writing 'I am in good health' on the report.

"After his discharge, plaintiff offered to return to duty in 1964. His request was denied March 24, 1964. The denial was accompanied by an application form for plaintiff's use had he desired to have his discharge administratively reviewed. Plaintiff failed to file the application. On May 12, 1972, plaintiff applied for compensation with the Veterans Administration (VA). A medical examination was conducted by the VA in August 1972. The VA granted plaintiff a ten percent (10%) disability rating. In July 1974, plaintiff applied to the ABCMR for expungement of his discharge and correction of his records to show retirement for

physical disability. The ABCMR, without opinion, denied relief on January 22, 1975. Plaintiff then filed this suit seeking disability retirement pay from April 18, 1962 and correction of his records to show that on April 17, 1962, he was retired for physical disability instead of discharged.

"For purposes of this motion, we will assume there is no statute of limitations or laches bar, and proceed to the merits of plaintiff's claim—that the ABCMR treated him unfairly.

"This court may only overturn a decision of the ABCMR when the decision is clearly unsupported by substantial evidence or when there is a noncompliance with applicable laws and regulations. *Jordan* v. *United States*, 205 Ct.Cl. 65 (1974); *Dorl* v. *United States*, 200 Ct.Cl. 626, 633, *cert. denied*, 414 U.S. 1032 (1973); *Towell* v. *United States*, 150 Ct.Cl. 422, 433 (1960). Plaintiff fails even to allege that the decision of the ABCMR is arbitrary, capricious, or not supported by substantial evidence. This court normally will not overturn the decision of a correction board without such allegations and proof. *Dorl* v. *United States*, *supra*.

"However, this court has been historically lenient in interpreting petitions and papers filed by *pro se* plaintiffs. *See, e.g. Sterner* v. *United States*, 197 Ct.Cl. 1064, 1065 (1972); *Clinton* v. *United States*, 191 Ct.Cl. 604, 605–06, 423 F.2d 1367, 1368 (1970); *Ruderer* v. *United States*, 188 Ct.Cl. 456, 468, 412 F.2d 1285, 1292 (1969). We therefore have analyzed and considered plaintiff's petition as if such allegations had been made.

"For plaintiff to be successful, he must meet the requirements of 10 U.S.C. § 1201 (1970). The applicable portions require that: 1) On April 17, 1962, plaintiff was unfit to perform duties because of physical disability incurred while entitled to basic pay; and 2) the disability must be at least thirty percent (30%) under the VA schedule of rating disabilities.

"The ABCMR, in discharging its function, requested an opinion from the Surgeon General, whose opinion it was that plaintiff was fit for duty on April 19 (sic), 1962. Additionally, the VA had found plaintiff's injury to be only ratable at ten percent (10%)—far below the thirty percent (30%) figure demanded by statute. Although not conclu-

sive, VA determinations are assuredly entitled to consideration. *Unterberg* v. *United States*, 188 Ct.Cl. 994, 1003, 412 F.2d 1341, 1346 (1969); *Hutter* v. *United States*, 170 Ct.Cl. 517, 522–23, 345 F.2d 828 (1965).

"After careful analysis of the exhibits submitted by defendant, including physical examination reports showing plaintiff's general good health, we hold the Board decision is clearly supported by substantial evidence. No interpretation of the evidence or of plaintiff's physical examination report would lead us to determine that the ABCMR decision was arbitrary and capricious.

"Accordingly, upon consideration of the petition, the motion, and supporting exhibits, but without oral argument, IT IS ORDERED that defendant's motion is granted and the petition is dismissed."

No. 378–73. FEBRUARY 18 and APRIL 1, 1977

Drakes Beach Club

Eminent domain; taking; just compensation; interest; Point Reyes National Seashore.—Plaintiff contends that by enactment of the Act of September 13, 1962, 76 Stat. 538, 16 U.S.C. § 459c, et seq., authorizing and establishing the Point Reyes National Seashore, and by defendant's subsequent activities (and nonactivities) in connection therewith, defendant took plaintiff's 4-acre tract of ocean front property in the Limantour area of Point Reyes peninsula in December 1970, and also asserts that the property had a fair market value of $180,650 as of the date of taking. On October 7, 1976 Trial Judge Harry E. Wood filed a recommended decision concluding as a matter of law that plaintiff is entitled to judgment against defendant for just compensation for the taking on December 31, 1970 of plaintiff's tract of land in the amount of $155,500, together with simple interest thereon, not as interest but as a part of just compensation, at the rate of 7% per annum from December 31, 1970, until paid. On February 18, 1977 the court adopted the recommended decision as the basis for its judgment in this case, except as to the treatment of

interest. However, with respect to interest, the court entered the following amendatory order on April 1, 1977:

William J. Turner, attorney of record, for plaintiff.

Herbert Pittle, with whom was *Assistant Attorney General Peter R. Taft,* for defendant.

Before SKELTON, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This matter is before the court on plaintiff's motion, filed March 7, 1977, asking us to reconsider and amend the order and judgment of February 18, 1977, in which the court granted plaintiff a recovery with interest, as part of just compensation, of 4 percent from December 31, 1970, until January 18, 1974, and 7 percent thereafter. Plaintiff now requests, without opposition from defendant, that the interest rate be set at 7 percent from December 31, 1970, until payment, in accordance with a stipulation made by the parties at trial. The order of February 18, 1977, declined the invitation to follow the stipulation, reasoning that to grant delay compensation at a rate greater than 4 percent until January 18, 1974, would run counter to the judgment awarded in *Drakes Bay Land Co.* v. *United States,* 198 Ct. Cl. 506, 459 F. 2d 504 (1972), a case which, like the present one, involved the inverse condemnation of lands for the Point Reyes National Seashore but did not involve a stipulation on interest.

"On March 23, 1977, the full court decided *Tektronix, Inc.* v. *United States, ante* at 257, 552 F.2d 343. In that case the majority opinion stated that the delay compensation rates established in *Pitcairn* v. *United States,* 212 Ct.Cl. 168, 547 F.2d 1106 (1976), 'should be applied (from now on) to just compensation cases, without need of proof in the individual instance * * *.' [*ante* at 274, 552 F.2d at 352]. The rate established in *Pitcairn* for the period 1971 to 1975 was 7.5 percent. [*ante* at 274, 552 F.2d at 352, n. 17, *Tektronix.*] *Tektronix* went on to except from its general rule the situation where, as here, the parties have stipulated that other interest rates should apply. [*Ante* at 275, 552 F.2d at 353, n. 19.] In view of the considerably higher delay compensation rate allowed in that case for the

period covering the present plaintiff's claim, and the majority's observation that either the *Pitcairn* rates or stipulated rates should be used in all future cases, we deem it appropriate to grant plaintiff's motion and amend the previous order to provide for interest, as part of the just compensation award, at the rate stipulated by the parties, 7 percent.

"IT IS THEREFORE ORDERED that this court's order in the present case, dated February 18, 1977, be amended by striking all after the first sentence thereof, and substituting the following therefor:

> "Upon consideration thereof, without oral argument, since the court agrees with the trial judge's recommended decision, copies of which have been furnished to the parties, it hereby grants their motions and affirms and adopts the said recommended decision as the basis for its judgment in this case. Judgment is accordingly entered for the plaintiff and the case is remanded to the trial judge to determine the exact amount of plaintiff's recovery in further proceedings pursuant to Rule 131(c)."

On October 14, 1977 the court entered judgment for plaintiff in the sum of $297,351.76, plus $37.74 per day for each day elapsing after September 30, 1977, until such total amount of gross recovery is paid by defendant to plaintiff; and, upon payment of the said total amount plaintiff will forthwith cause payment, discharge or cancellation to be made of all real property taxes which are a lien upon the property which is the subject of this action and which are allocable to the portion of the 1977–1978 fiscal year from July 1, 1977 through December 31, 1977, and all periods prior thereto, and defendant will accept title to said property subject to the lien of any real property taxes which is allocable to any period commencing from and after January 1, 1978.

No. 209–75. FEBRUARY 18, 1977

General Motors Corporation

Water pollution; oil spill clean-up costs; prior adjudication; collateral estoppel.—On February 18, 1977 the court entered the following order:

Ralph C. Dixon, attorney of record for plaintiff. *Frazer F. Hilder, Dennis Minano, James L. Ackerman, Robert P. Knickerbocker, Jr.,* and *Day, Berry & Howard,* of counsel.

Douglas K. Miller, with whom was *Assistant Attorney General Peter R. Taft,* for defendant. *Alfred T. Ghiorzi,* of counsel.

Before SKELTON, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"General Motors Corporation seeks reimbursement for clean-up expenses it incurred in combating an oil spill from tanks it owned in Bristol, Connecticut. On or about April 18, 1973, oil in harmful quantities was discharged into the Pequabuck River, navigable waters of the United States from an onshore facility (known as the Northside Plant) owned and maintained by General Motors' New Departure-Hyatt Division in Bristol. General Motors had ceased using the plant for manufacturing operations in 1971, and prepared to offer it for sale. At the time of the discharge, the facility was maintained in a closed condition, and the oil tanks had been drained, except for a reserve needed to provide boiler fuel for heating the facility to protect against equipment freezing in the event of extremely cold weather. The oil storage tanks were protected by a 10-foot high fence topped with barbed wire, with the fence chained and locked. A second fence 12 feet high and topped with barbed wire surrounded the perimeter of the plant. This fence was also chained and locked. In addition, the plant was regularly patroled by the Bristol Police Department and by General Motors personnel on weekends. In spite of these security precautions, vandals gained access to the tanks on April 18, 1973, and opened at least two of the valves on the tanks, and the oil spill resulted. These facts are admitted by the government.

"Plaintiff, upon discovering the oil discharge, immediately dispatched its employees to the area to begin cleanup and containment operations. The removal operations lasted for 10 days and resulted in the removal of substantially all of the oil. Plaintiff incurred costs of $16,202.48 and in this suit seeks to recover those costs from defendant under the provisions of 33 U.S.C. § 1321 (i)(1) (Supp. V, 1975), which states:

> In any case where an owner or operator of a vessel or an onshore facility or an offshore facility from which oil or a hazardous substance is discharged in violation of subsection (b)(3) of this section acts to remove such oil or substance in accordance with regulations promulgated pursuant to this section, such owner or operator shall be entitled to recover the reasonable costs incurred in such removal upon establishing, in a suit which may be brought against the United States Government in the United States Court of Claims, that such discharge was caused solely by (A) an act of God, (B) an act of war, (C) negligence on the part of the United States Government, or (D) an act or omission of a third party without regard to whether such act or omission was or was not negligent, or of any combination of the foregoing causes.

"In a prior action, *United States* v. *General Motors Corp.*, 403 F.Supp. 1151 (D. Conn. 1975), the government filed a complaint in federal district court against General Motors to enforce the collection of a $1,200 penalty assessed by the United States Coast Guard for the same oil discharge as is the subject of this litigation. General Motors denied the legality of the imposition of the penalty and asserted as a complete defense that the oil discharge was caused solely by the act or omission of a third party. The parties filed a stipulation of facts, which provided that the discharge was caused by the acts of a third party or parties unknown. On October 24, 1975, the federal district court rejected General Motors' claim of an absolute defense and thereafter entered judgment for the United States in the amount of one dollar.

"The plaintiff contends in the present case that the government is, because of its admissions in the prior case, collaterally estopped from denying in this action that the

discharge was caused solely by the acts or omissions of third parties. We agree. Collateral estoppel requires the following elements for its application: (1) the fact to be concluded must be an ultimate fact determined in the prior action; (2) it must have been raised in the prior action and have been necessary to the prior judgment, and (3) there must be a final judgment affecting the same parties. *Overseas Motors, Inc.* v. *Import Motors, Ltd.*, 375 F.Supp. 499, 510–11 (E.D. Mich. 1974). *See United Shoe Machinery Corp.* v. *United States*, 258 U.S. 451, 459 (1922); *Cromwell* v. *County of Sac.*, 94 U.S. 351, 352–53 (1876); *Seminole Nation of Oklahoma* v. *United States*, 203 Ct. Cl. 637, 645–6, 492 F.2d 811, 816 (1974); *Forrest Village Apartments, Inc.*, v. *United States*, 178 Ct. Cl. 490, 371 F.2d 500 (1967); *Adams* v. *United States*, 175 Ct. Cl. 288, 358 F.2d 986 (1966).

"All these elements are present here. The district court specifically found that General Motors 'was not negligent or at fault in any way for this discharge of oil. * * * its culpability was zero; * * *.' 403 F. Supp., *supra*, at 1164. Thus, the decision of the district court determined that the discharge was caused solely by the act or omission of a third party or parties unknown.

"The government seeks to rely on *City of Pawtucket* v. *United States*, 211 Ct. Cl.324(1976). The facts in that case are quite different from those in the present controversy. The city, plaintiff in that case, was guilty of numerous omissions, and those omissions constituted a cause of the oil spill there. A third party was not the sole cause, and thus the city was not entitled to recover. As outlined above, that is not the situation here.

"For all the foregoing reasons, without oral argument, and upon the authority of 33 U.S.C. § 1321 (i)(1), *supra*, and *United States* v. *General Motors Corp.*, 403 F.Supp. 1151 (D. Conn. 1975), IT IS ORDERED that the plaintiff's motion for summary judgment as to liability is granted and the case is remanded to the trial judge for determination of the amount of damages to be paid to plaintiff in accordance with Rule 131(c)."

No. 204–76. FEBRUARY 18, 1977

Michael D. Calderazzo

Civilian pay; reassignment; discretion of employing agency.—On February 18, 1977 the court entered the following order:

Herbert S. Rosenblum, attorney of record, for plaintiff. *Marc J. Fink*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Reed L. Von Maur*, of counsel.

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"This claim for back pay is before the court on defendant's motion for summary judgment and plaintiff's response thereto. Plaintiff was a GS–14, nonveteran, supervisory physicist at the defendant's Harry Diamond Laboratories (HDL), Department of the Army, Woodbridge, Virginia. He was removed from his position on April 29, 1974, for persistent refusal to accept reassignment from the location at Woodbridge to Washington, D. C., to a new position with the same rank, grade, and pay. Plaintiff attacks the transfer as an abuse of discretion, the product of bad faith and malice, and that his rights were violated by the Civil Service Commission (CSC) in his pursuit and exhaustion of administrative remedies. He says that these allegations raise triable issues of fact and must defeat the motion.

"A careful examination of the papers before the court, including a certified copy of the record of the CSC, convinces us that plaintiff's claim is without merit, that the transfer ordered was a valid management decision, that he was properly discharged for the efficiency of the service, and without malice, bad faith, abuse of discretion, or violation of any regulations by his agency or CSC.

"It is well settled that under the applicable regulations regarding reassignments, 5 C.F.R. §§ 335.102 and 305.505 (1975), and the judicial precedents, agencies of the Federal Government have broad latitude to make reassignments of employees and that the court will not overturn their actions unless satisfied that such transfers are an abuse of

discretion or are disguised adverse actions mandating procedures which have been violated. The record does not support a conclusion that the challenged transfer here was motivated by such considerations as raise triable issues, such as bad faith or malice. This is so, considering the pleadings in the light most favorable to plaintiff. On the contrary, plaintiff was not singled out for transfer as he was one of some 20 employees ordered to be transferred. He was selected because he was the best qualified, because the workload of the agency required it, and upon written assurances to him that the move would not adversely affect his future job opportunities. He was promised financial assistance in relocating his residence. His real complaint appears to be a matter of personal preference as to where he would work and a charge that his commuting time would be increased by the transfer. This belief is not without doubt in the record. He also complains of a lack of security clearance but this does not appear relevant to the reassignment, nor is the denial of his request for a 30-day extension of the effective date of transfer, nor his civil action against a prior employer, nor his grievance complaint about a prior temporary reassignment, which complaint he did not pursue. We cannot find the pattern of harassment which plaintiff alleges. Finally, the hearing plaintiff was afforded by CSC is without fault. Plaintiff's trouble was his intransigence and his failure to report at his new duty station in January 1974 when he was ordered to do so. He was then placed on absent status, and on April 29, 1974, was removed. He had ample notice of this proposed action. In fact he had asked to be separated if the reassignment was not revoked. His excuses are frivolous and do not permit the conclusive inferences he would have us make to support his contentions. Upon consideration of the motion and response, without oral argument, and on the authority of the aforesaid regulations and *Urbina* v. *United States*, 209 Ct. Cl. 192, 530 F. 2d 1387 (1976); *Comberiate* v. *United States*, 203 Ct. Cl. 285 (1973); *Burton* v. *United States*, 186 Ct. Cl. 172, 404 F. 2d 365 (1968), *cert. denied*, 394 U.S. 1002 (1969); and *Colbath* v. *United States*, 169 Ct. Cl. 414, 341 F. 2d 626 (1965),

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment be and it is granted. The petition is dismissed."

No. 319-76. FEBRUARY 18, 1977

Alvah T. Healy

Military pay; demotion and discharge; correction of military records to show physical disability discharge; limitation of actions; finality of decision of Correction Board; tort claim.—On February 18, 1977 the court entered the following order:

Alvah T. Healy, pro se, for plaintiff.

LeRoy Southmayd, with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Before SKELTON, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This *pro se* case comes before the court on defendant's motion to dismiss and plaintiff's opposition thereto. Warrant Officer Healy (Ret.) asks the court to grant him relief in claims arising from his separation from the Marine Corps on August 1, 1970. For the reasons stated below, we hold for the Government and dismiss the case.

"Plaintiff Healy seeks judgment for claims in three areas. First he claims back pay to the rank of Warrant Officer as compensation for his supposedly illegal demotion and discharge. Second, he asks for an Honorable Medical Discharge and a Service Medical Rating equal to his Veterans Administration (VA) rating of 100 percent disabled. Finally, Healy claims a total of $750,000.00 as damages for malpractice and defamation.

"Facts pertinent to this case (as alleged by Healy) start with Healy's referral to the psychiatric ward, U.S. Naval Hospital, Bethesda, Maryland, by his commanding officer on March 2, 1967. At that time, Healy was on active duty with the Marine Corps as a Warrant Officer. Subsequent to his release (it appears), he received bad fitness reports and

was reduced in rank from Warrant Officer to Gunnery Sergeant, E–7, in 1968.

"On August 1, 1970, Healy was discharged from active duty (allegedly illegally and against his will) after a final medical examination found him fit for release. On the same day Healy was transferred to the Temporary Disability Retired List and to the Fleet Marine Corps Reserve.

"Immediately after discharge, Healy went to the VA in San Diego, California. Upon examination by the VA, Healy was found totally and permanently service-connected disabled for twelve disabilities, a (combined) rating of 100 percent. He claims the discrepancy later between his final service physical and the VA rating as the basis for his malpractice allegation and for his claim of entitlement to an Honorable Medical Discharge.

"In October 1970, plaintiff received a reply to a request he had made for assistance to then-Representative L. Mendel Rivers. Healy claims this letter, from a ranking Naval Officer, labels him a liar and thus defames his character. For the alleged defamation, he seeks $250,000.00.

"On February 11, 1975, Healy was granted a Physical Evaluation Board Hearing in connection with a Board of Correction of Naval Records (BCNR) review of his case. At that time, his Service Medical Rating was increased from 20 percent (assigned by the BCNR in 1972) to 40 percent. Plaintiff alleges that this increase shows he was disabled at the time of discharge. Together with his illegal demotion and discharge claim, it forms the basis for his back pay claim.

"In examining Healy's complaint, we recognize that it is due a liberal reading. Not only is this a *pro se* action, but the complaint is being challenged by a motion to dismiss. In this posture, all inferences must be drawn in favor of plaintiff. *See Scheuer* v. *Rhodes*, 416 U.S. 232, 236 (1974). However, even under this standard, we fail to find a cause of action stated in the complaint.

"First, Healy's back pay claim is barred by the six-year statute of limitations, 28 U.S.C. § 2501 (1970). Healy was discharged on August 1, 1970. This suit was not filed until August 2, 1976. Even though the filing exceeds the six-year

limit by only one day, we find no reason in this case to ignore the statutory proscription.

"It is firmly established that a claim for active duty pay must be brought within six years of date of discharge. *See, e.g., Kirby* v. *United States*, 201 Ct.Cl. 527 (1973), *cert. denied*, 417 U.S. 919 (1974). The review of Healy's situation by the BCNR did not toll the running of the statute of limitations. *E.g., Kirk* v. *United States*, 164 Ct.Cl. 738, 742–43 (1964). Finally, Healy has stated no extenuating circumstances which should require us to relax this rule that discourages tardy plaintiffs.

"Next, Healy's claim for an Honorable Medical Discharge and change in his Service Medical Rating only succeed if there is some set of facts alleged upon which arbitrary and capricious action by the BCNR can be proved. This is a heavy burden on plaintiff. *Storey* v. *United States*, 209 Ct.Cl. 174, 178, 531 F.2d 985, 987 (1976). Absent some facts showing that the BCNR acted arbitrarily, capriciously, or that the BCNR's decision is not supported by substantial evidence, this court cannot overturn the BCNR's decision, even if it disagrees with it. *Storey, supra*, 209 Ct.Cl. at 179, 531 F.2d at 987.

"After thorough examination of the facts alleged in this case, and drawing every inference in favor of the plaintiff, *Scheuer* v. *Rhodes, supra*, we cannot find a set of facts which shows the BCNR acted in any way improperly. Therefore, we hold plaintiff has failed to state a cause of action in his claim for change of his military records.

"Finally, plaintiff's claims for damages grounded in malpractice and defamation are outside the jurisdiction of this court. The Court of Claims does not have original jurisdiction over tort claims. *McCreery* v. *United States*, 161 Ct.Cl. 484, 488 (1963). Healy's claims definitely sound in tort.

"Nor would any purpose be served by transferring this case, pursuant to 28 U.S.C. § 1506 (1970), to the appropriate district court. These claims arose, at the latest in 1972. The statute of limitations with regard to tort claims against the United States is two years. 28 U.S.C. § 2401 (1970).

"In summary, Healy's claims are either too late, fail to state a cause of action, or lie outside the court's jurisdic-

tion. Therefore, upon consideration of the complaint, defendant's motion to dismiss, plaintiff's opposition thereto, and without oral argument, IT IS ORDERED that defendant's motion to dismiss is granted and the case is dismissed."

Nos. 344–76, 345–76, 362–76, 371–76, 372–76, 456–76, 457–76, 458–76, 459–76, 502–76, 503–76, 504–76, 516–76. FEBRUARY 25, 1977

Anderson Snapper Boats, Inc., et al.

Taxes; employment taxes; employee-independent contractor; remand to trial judge.—On February 25, 1977 the court entered the following order:

Joseph J. Lyman, attorney of record for plaintiffs.

W. C. Rapp, with whom was *Acting Assistant Attorney General Myron C. Baum,* for defendant.

Before COWEN, *Chief Judge,* NICHOLS and KASHIWA, *Judges.*

"These cases come before the court on defendant's request for review of the trial judge's order of January 5, 1977, in which he consolidated docket nos. 502–76, 503–76, 504–76 and 516–76, with nine similar cases previously consolidated by orders of September 22, 1976 and December 1, 1976. The trial judge has certified the question for review pursuant to Rule 53(c)(2)(i).

"Upon consideration thereof, the court finds that these cases involve plaintiffs' liability for employment taxes and that the issue to be decided is the status as employees or individual contractors of the captains and crewmen engaged to operate shrimp boats and snapper boats owned by the plaintiffs. Although the court believes that questions of this kind usually fall in a category in which we decline to disturb the action of the trial judge, we are remanding the matter to him for reconsideration in the light of the following comments:

"1. As has been indicated in a number of cases decided by the court, the employment tax cases turn on the particular facts of each case and an assessment of the

overall situation based upon such facts. *See Cape Shore Fish Co. v. United States,* 165 Ct. Cl. 630, 330 F.2d 961 (1964); *Kirkconnell v. United States,* 171 Ct. Cl. 43, 347 F.2d 260 (1965), and *Tristate Developers, Inc. v. United States,* 212 Ct. Cl. 486, 549 F.2d 190 (1977). These cases may be exceptions to the general rule, but it has been the experience in similar cases that the testimony of most of the witnesses will necessarily relate to the one case with which they are familiar and will not be of the kind that can be used to decide the issues in other cases.

"2. Because of the striking factual differences that recur between employment tax cases involving even the same industries, the court is of the opinion that these cases are not suitable for treatment as a class action.

"3. In view of the matters stated in 1 and 2, the trial judge, after further reflection, may well conclude that it would not be unfair to the plaintiffs in the four cases covered by his order of consolidation to set aside the order and to give further consideration to the burden that may be imposed on the attorneys for both parties by consolidating so many cases, each of which may require proof of different facts by different witnesses, although they appear to have some general similarities.

"4. On reconsideration, the trial judge may also find that the consolidation ordered may lead to confusion and prejudice to both parties. *See United States v. Lustig,* 16 F.R.D. 378 (S.D.N.Y. 1963).

"After he has reconsidered his order, the trial judge may also wish to fix a different schedule for compliance with the pretrial order filed October 13, 1976, as amended by the order of January 5, 1977."

On March 15, 1977 the trial judge filed an order rescinding the orders of consolidation.

No. 310–62. FEBRUARY 25, 1977 and APRIL 8, 1977

Union Pacific Railroad Company

This case has been before the court previously. *See* 182 Ct. Cl. 103, 389 F.2d 437; 185 Ct. Cl. 393, 401 F.2d 778, *cert. denied,* 395 U.S. 944; 194 Ct. Cl. 1021, *cert. denied,* 403 U.S.

931; 208 Ct. Cl. 1, 524 F.2d 1343, *cert. denied*, 429 U.S. 827. On February 25, 1977 the court entered the following order:

"This case comes before the court on plaintiff's exceptions, filed December 13, 1976, to the supplemental opinion and recommended decision of Trial Judge David Schwartz, filed October 22, 1976, pursuant to the order of reference, Rule 134(h), and the remand by the court dated October 22, 1975. Upon consideration thereof, together with defendant's response thereto requesting that the court adopt the trial judge's supplemental opinion and plaintiff's reply, and without oral argument, since the court agrees with the trial judge's recommended decision, copies of which have been furnished to the parties, it hereby denies plaintiff's exceptions and adopts the said recommended supplemental opinion as the basis for its judgment herein.

"IT IS THEREFORE CONCLUDED AND ORDERED that on the basis of the earlier opinion of November 29, 1973, and the trial judge's findings and supplemental opinion adopted by the court, plaintiff is not entitled to prevail on Count 8 and that portion of plaintiff's petition is dismissed."

On April 8, 1977 the court entered the following order:

"This case comes before the court on a stipulation of the parties filed March 25, 1977, signed on behalf of the plaintiff and the defendant by the respective attorneys of record and by the Acting Assistant Attorney General, in which the parties agree that as a result of the various decisions issued by the court in this case, including the order of February 25, 1977, there is a barred deficiency in tax for 1942; that there is no overpayment of tax or interest; that the issues reserved for separate trial are moot; and that plaintiff is not entitled to recover any amount.

"IT IS THEREFORE ORDERED that the case is now closed and, accordingly, except as to any issues on which plaintiff may have prevailed, the petition is dismissed."

No. 311-75. FEBRUARY 28, 1977

Jack E. McGahey

Military pay; correction of military records; laches.—On February 28, 1977 the court entered the following order:

Charles M. Munnecke, attorney of record for plaintiff.

Robert M. Hollis, with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Before COWEN, *Chief Judge,* DAVIS and SKELTON, *Judges.*

"Plaintiff is a former Air Force Major who was relieved from active duty on March 31, 1970. He sues for disability retirement pay and asks the court to enter an order placing him on the retired list in the grade of major as of March 31, 1970 with entitlement to appropriate retired pay. He claims that he was arbitrarily denied a Medical Evaluation Board at the time of his retirement, and that on the basis of his documented physical condition, the Board would have found him entitled to retirement for disability with such resulting retirement pay. We find it unnecessary to rule upon the issue of plaintiff's physical condition on March 31, 1970 and the propriety of the decision of the Air Force to certify plaintiff fit for duty as of his retirement date, because we conclude that plaintiff has been inexcusably dilatory in the prosecution of his claim and that this action is barred by the doctrine of laches.

"Beginning with the summer of 1969, plaintiff experienced a number of medical problems, including the removal of his spleen; he was hospitalized intermittently until March 5, 1970. In September 1969, plaintiff (a lawyer) was notified that he was to be separated from his position with the office of the Judge Advocate General as of March 31, 1970, for budgetary reasons under a reduction-in-force program. A final physical examination was held February 6, 1970, at which time plaintiff alleged that he requested from the attending physician a Medical Evaluation Board and that this request was denied. Plaintiff was certified fit for active duty and final separation occurred on March 31, 1970.

"Some 3 months after his separation, plaintiff was hospitalized for hypertension and was plagued with other medical problems throughout the fall and winter of 1970. Having secured a 40 percent disability rating from the Veterans Administration (VA) in the summer of 1970, plaintiff applied to the Air Force Board for the Correction of Military Records (BCMR) on August 8, 1970, seeking to have his records changed to reflect retirement for disability, rather than for budgetary reasons. This application was denied October 26, 1970. Plaintiff first obtained a 50 percent disability rating from the VA on July 27, 1970, and a 60 percent disability rating as of June 24, 1972. His second application to the BCMR was made July 26, 1972 and denied August 4, 1972; a third application was made September 18, 1973 and denied February 19, 1974. Plaintiff made his last application to the BCMR on November 21, 1974 and it was denied April 30, 1975. Suit was not instituted here until August 19, 1975.

"Notwithstanding the Government's fascination for paring down the statute of limitations by the routine pleading of laches in nearly all of these cases, we limit the application of that doctrine to circumstances in which the delay has been unreasonable and the Government has, as a result thereof, been prejudiced. Here, those circumstances do exist. Defendant has argued that the accrual date of plaintiff's cause of action should be March 31, 1970—the date of his separation. This would amount to a delay of 5 years and 4 months before suit was instituted in this court. While we have long recognized that correction board relief is generally a permissive administrative remedy (*Friedman v. United States*, 159 Ct. Cl. 1, 310 F.2d 381 (1962), *cert. denied sub nom. Lipp*, 373 U.S. 932 (1963), we have expressed our reluctance to impose the bar of laches in such a way as to discourage prompt, good faith pursuit of permissive administrative remedies. *Steuer v. United States*, 207 Ct. Cl. 282, 295 (1975). We think a fairer date from which to measure the delay in bringing suit to be the time of the first denial by the BCMR of plaintiff's application for correction of his retirement status, *i.e.*, October 26, 1970. This delay amounts to 4 years and 10 months.

"After the first denial of his application for correction, plaintiff should not be credited for his further efforts to pursue that course, while all the facts necessary for a judicial evaluation of his factual contentions about his physical condition on March 31, 1970, were becoming increasingly stale. Plaintiff's tardiness in bringing suit in this court must be viewed in light of the fact that he is an attorney, who is charged with a knowledge of his rights and the legal effects of his actions. Plaintiff's delay has clearly created a prejudice to the Government, because there is such a sharp dispute in the material facts regarding plaintiff's physical condition on March 31, 1970, that the question cannot be resolved on the motions for summary judgment. Citing *Brown v. United States*, 184 Ct. Cl. 501, 396 F.2d 989 (1968), plaintiff argues that if summary judgment is not rendered in his favor, he is entitled to a trial *de novo*. Defendant contends that in view of the enactment of P.L. 92–415, 28 U.S.C. §1491 (Supp. V, 1975), the *Brown* case should no longer be followed and the case should be remanded to the military medical boards for an initial determination. We do not agree with the broad contention that a trial *de nova* is precluded in all cases of this kind because of the enactment of P.L. 92–415. For the purposes of this case we hold that we would remand the case to the Trial Division for a *de novo* determination of plaintiff's disability were it not for his unreasonable delay in bringing suit. The prejudice to the Government lies in the fact that the witnesses who were familiar with plaintiff's physical condition at the time of his discharge, including any doctor who examined him then, may no longer be available, and even if they are, their memories of the pertinent facts have in all probability evaporated as the result of the passage of time.

"Since plaintiff had the knowledge to request a Medical Evaluation Board at his separation physical, and to seek correction of his records within 4 months of his separation, it is apparent that he was aware of his claim. No relevant facts were hidden from him. Possessing the requisite legal skill to understand or ascertain the consequences of his repeated, gratuitous applications to the BCMR, plaintiff is properly penalized by the doctrine of laches in a situation

where the delay was almost entirely his fault and results in prejudice to the Government.

"Defendant's motion for summary judgment is therefore granted; plaintiff's motion for summary judgment is denied, and plaintiff's petition is dismissed."

Plaintiff's motion for reconsideration *en banc* was denied May 27, 1977.

No. 321-76. FEBRUARY 28, 1977

Harry F. Weber

Military pay; correction of military records; entitlement to retired pay; computation of years of service; laches.—On February 28, 1977 the court entered the following order:

James R. Kniffen, attorney of record, for plaintiff.

Richard J. Webber, with whom was *Acting Assistant Attorney General Irving Jaffe,* for defendant.

Before COWEN, *Chief Judge,* DAVIS, SKELTON, NICHOLS, KASHIWA, and BENNETT, *Judges, en banc.*

"This case comes before the court on defendant's motion to dismiss plaintiff's claim for military retired pay, and has been considered *en banc* on defendant's suggestion.

"Plaintiff is a former lieutenant colonel in the United States Army Reserve, a citizen and resident of Tennessee, and a dentist by profession. He was commissioned on March 13, 1931, and was honorably discharged on April 1, 1953. He had 18 years, 2 months, and 20 days of service creditable toward retirement, all earned prior to July 1, 1949. On July 8, 1966, he reached 60 years of age. Pursuant to 10 U.S.C. § 1331 (1970) a Reserve officer with 20 years of qualifying service is entitled, upon application, to retired pay at age 60. For years subsequent to July 1, 1949, fifty points earned by participation in qualifying military activities were required for a satisfactory retirement year. 10 U.S.C. § 1332 (1970). Plaintiff did not make prompt application for retired pay when he reached 60 years of age but waited until June 1973, when he was almost 67 years of

age, to do so. He stated on the application that the number of his earned retirement points was 'unknown.'

"Plaintiff's application was disapproved in November 1973 because there were no records which verified his claim of 20 years of qualifying service. Records which allegedly would have shown that he had earned the necessary points to complete 20 years were destroyed in a fire in July 1973 at the Army Reserve Component Personnel and Administrative Center in St. Louis. In 1974 plaintiff submitted a new application stating: 'At least 55 points earned each year.' In 1975 plaintiff appealed the adverse decision to the Army Board for Correction of Military Records which denied the appeal on April 6, 1976, because of insufficient documentation to support the claim for service subsequent to July 1, 1949. The petition was filed August 6, 1976.

"Defendant's motion to dismiss asserts that the claim is barred by the 6-year statute of limitations, 28 U.S.C. § 2501 (1970), since the petition was filed over 10 years after plaintiff became eligible for retired pay, and alternatively is also barred by laches because the delay of almost 7 years in applying for retired pay, after reaching the eligible age, has critically prejudiced defendant's ability to defend the lawsuit.

"The doctrine which forfeits a claim because of unreasonable, inexcusable delay which prejudices defendant is firmly established. *Brundage* v. *United States*, 205 Ct. Cl. 502, 504 F. 2d 1382 (1974), *cert. denied*, 421 U.S. 998 (1975); *Steuer* v. *United States*, 207 Ct. Cl. 282 (1975). Here, had plaintiff applied for retirement with reasonable promptness after 1966, the matter could have been ruled on and the fire of 1973 would not have hampered defendant, as it does now, in defense of this claim. Plaintiff of course was not responsible for the fire but he was responsible for the years of delay prior to the fire. Plaintiff seeks to overcome this deficiency in his case by supplying us with his affidavit, made in 1975, attesting that he attended the requisite number of training sessions to qualify for the additional time to round out 20 good years for retirement purposes. He gives us, also, affidavits made in 1974 by two personnel sergeants and an administrative officer of his

unit who state that it is their belief plaintiff earned the necessary points between July 1, 1949, and July 10, 1951. Plaintiff's affidavit said that the requisite points were earned through 1953. No particulars are provided. If plaintiff or the other affiants kept any records to support their recollection of the details of plaintiff's participation in Reserve meetings as long ago as 25 years, they do not offer them. We just cannot accept the proffered evidence as viable to support a claim for 10 years in back pay and future retired pay. We do not have to doubt plaintiff's participation in some Reserve drill activities during the period, but the statute mandates specific accomplishment of earned points. Proof thereof has been effectively frustrated by plaintiff's delay in making his claim and the memory of such details a quarter of a century ago is too flimsy to predicate a judgment on it. The prejudice to defendant in this matter is manifest.

"This claim is incredibly stale. Plaintiff's response that he was ignorant of his rights until 1973 does not excuse his undue, prejudicial delay. *Morales* v. *Bull* S.S. Co., 279 F. 2d 299 (1st Cir. 1960); *Harris* v. *Lykes Bros. S.S. Co.*, 375 F. Supp. 1155 (E.D. Tex. 1974). He is presumed to know those rights and it would be a rare Reserve officer, one totally indifferent to his training obligations, to be so uninformed. Such indifference, if accepted, does nothing to strengthen plaintiff's claim of devoted adherence to creditable training requirements to qualify for retirement.

"Having concluded plaintiff's claim is without merit on the grounds of laches, we do not reach the defense of the statute of limitations.

"Upon consideration of the petition and affidavits, defendant's motion to dismiss, and plaintiff's response thereto, the court *en banc*, without oral argument, and upon authority of the cases cited above,

"THEREFORE ORDERS that the motion to dismiss be granted, and the petition is dismissed."

No. 130-70. MARCH 4, 1977

Leesona Corporation

Patents; infringement; compensation; attorneys' fees.—On March 4, 1977 the court entered the following order:

A. W. Breiner, attorney of record, for plaintiff. *Robert F. Conrad*, of counsel.

A. David Spevack, with whom was *Acting Assistant Attorney General Irving Jaffe*.

Before NICHOLS, *Judge*, Presiding, COWEN, *Senior Judge*, and KASHIWA, *Judge*.

"This case comes before the court pursuant to our Rule 53 on defendant's request for review of the trial judge's ruling that evidence submitted by plaintiff with respect to attorneys' fees and legal expenses incurred by plaintiff as a result of defendant's taking a license under plaintiff's patents would be received. The question of admissibility was certified by the trial judge in accordance with Rule 53(c)(2)(i).

"This action was brought under 28 U.S.C. § 1498(a) (1970) to secure reasonable and entire compensation for the unauthorized use of seven patents owned by plaintiff. In *Leesona Corp.* v. *United States*, 208 Ct. Cl. 871, 530 F.2d 896 (1976), this court held three of these patents valid and infringed and remanded the case for an accounting pursuant to Rule 131.

"Plaintiff in a pretrial brief and preliminary findings of fact, filed pursuant to Pretrial Order No. 1, contended that it is entitled to attorneys' fees as part of reasonable compensation under 28 U.S.C. § 1498(a). Plaintiff requested the following finding:

> 24. As a result of defendant's taking of a license under plaintiff's patents, plaintiff has expended in excess of $310,000 in litigation fees and expenses leading to the trial court's holding of validity of its patents. Accordingly, as a part of reasonable and entire compensation, plaintiff is to recover litigation fees and expenses, and ten (10%) percent interest on said fees and expenses continuing from point of incurrence, commencing on April 20, 1970 through payment.

Plaintiff also included a prayer for attorneys' fees as part of its requested conclusions of law. Plaintiff relies on *Pitcairn* v. *United States*, 212 Ct. Cl. 168, 547 F.2d 1106,

and the reference therein (*see* 212 Ct. Cl. at 194, 547 F.2d at 1122–23) to *King* v. *United States*, 205 Ct. Cl. 512, 504 F.2d 1138 (1974), to support its request for attorneys' fees.

"At a final pretrial conference, January 3, 1977, defendant stated its intention to object to the inclusion of evidence regarding attorneys' fees. The trial judge preliminarily ruled that evidence of attorneys' fees would be admitted. This preliminary ruling was incorporated into the *Memorandum of Pretrial Conference*, filed January 4, 1977, stating:

> In view of the trial judge's interpretation of *Autogiro* v. *United States*, evidence will be received with respect to attorney's fees notwithstanding defendant's reliance upon *Calhoun* v. *United States* or the absence of a specific statute authorizing an award of attorney's fees, *per se*.

"On the second day of trial, January 5, 1977, plaintiff offered exhibit PXA8, a compilation of attorneys' fees and expenses, and sought to elicit testimony in support of the compilation contained in the exhibit. Defendant objected on the grounds that the exhibit document and testimony were not relevant in an accounting to determine reasonable and entire compensation under 28 U.S.C. § 1498(a). Defendant's objection was overruled and the testimony and exhibit PXA8 were admitted.

"On January 9, 1977, the trial judge noted on record that a motion, *Second Request for Rehearing and Reconsideration*, had been filed in *Pitcairn* v. *United States*, *supra*. The trial judge then certified 'the question of admissibility of the evidence of attorneys' fees' because of the reference to the instant case in the *Pitcairn* motion and the similarity of legal issues involved in both cases.

"This Rule 53 motion has been timely filed following the certification.

"The issue of whether attorneys' fees and expenses could form part of reasonable compensation, as presented in this case, was addressed and decided in *Calhoun* v. *United States*, 197 Ct. Cl. 41, 453 F.2d 1385, 172 USPQ 438 (1972), and *Regent Jack Manufacturing Co.* v. *United States*, 155 Ct. Cl. 222, 292 F.2d 868, 130 USPQ 235 (1961).

"Congress can award more than the constitutionally mandated 'just compensation.' In the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, 42 U.S.C. § 4654(c) (1970), cited in *King* v. *United States*, 205 Ct. Cl. at 520, 504 F. 2d at 1143, Congress provided for an award of attorneys' fees and expenses in addition to 'just compensation.' However, Congress has passed no such statute awarding attorneys' fees and litigation expenses in a 28 U.S.C. § 1498 action. Therefore, *Calhoun* and *Regent Jack* are still determinative of this issue. The recent decision in *Pitcairn* v. *United States*, *supra*, is not authority to the contrary. The statement at 212 Ct.Cl. 192–3, 547 F.2d 1121–22, nowhere recites that attorneys' fees could ever be made a part of compensation under 28 U.S.C. § 1498. Furthermore, after considering the requests for rehearing in *Pitcairn*, this court by order deleted the citation to *King*, *supra*, and clarified any possible ambiguity raised thereby. *Pitcairn* v. *United States*, 212 Ct. Cl. 224 (Order of March 4, 1977).

"In view of this court's precedent and policy, evidence of attorneys' fees and litigation expenses is inadmissible as evidence in an accounting under 28 U.S.C. § 1498 since it is not relevant to the issue of 'reasonable and entire compensation.' Therefore,

"IT IS ORDERED that PXA8 and all testimony related to the exhibit and attorneys' fees is stricken from the record."

On April 29, 1977 the court denied plaintiff's motion for reconsideration *en banc*.

No. 157–74. MARCH 15, 1977

Larry C. Sanders

Military pay; correction of military records; selection for promotion.—On March 15, 1977 the court entered the following order:

Maurice F. Biddle, attorney of record for plaintiff. *Thomas H. King*, of counsel.

R. W. Koskinen, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

Before NICHOLS, KUNZIG and BENNETT, *Judges.*

"This case was argued March 11, 1977. The court is concerned by the number of suits by officers discharged after being passed over by Selection Boards, its uncertainty as to the best interests of the Services in the premises, as to its own proper role. In consideration of the importance of issues raised by this case in relation to other cases now pending, (*e.g., Guy* v. *United States,* No. 14–75 and *Riley* v. *United States,* No. 206–73) the court directs that within 30 days of March 11 defendant file supplemental briefs setting forth its position on each of the questions stated below. Plaintiff may file his response to the court within 30 days of defendant's filing. Other interested parties may apply for leave to submit briefs stating their positions, as amici curiae, within the time allotted.

"Defendant shall address the following questions:

"1. Whether a Board for the Correction of Military Records, once it has determined that an officer's effectiveness report is defective and should be removed from his file, is further obliged by law to void any prior passovers for promotion that either (a) are shown to have resulted, or (b) could have resulted from the selection board's consideration of the defective effectiveness report.

"2. Whether an officer who was passed over for promotion can and must show this court, in a suit for back pay and reinstatement, that he would have been selected for promotion by his selection board but for the existence of the legal error or injustice in the course of his review by the board; and if he cannot or need not make a 'but for' showing, whether he must still adduce proof meeting some alternative test.

"3. Whether this court may or should assume that a Correction Board's action directing the removal of an officer's effectiveness report was based on the board's conclusion that permitting the report to remain in the selection folder would have been legal error, rather than amounting only to an injustice, in the absence of specific statement.

"4. Whether there is legal error in the failure to accord an officer a promotion selection review free of defective effectiveness reports.

"5. Whether *Testan* v. *United States*, 424 U.S. 392 (1976), *rev'g* 205 Ct. Cl. 330, 499 F. 2d 690 (1974), forecloses this court's jurisdiction to review Correction Board decisions where the sole allegation is the board's arbitrary and capricious refusal to relieve an injustice, *Duhon* v. *United States*, 198 Ct. Cl. 564, 461 F. 2d 1278 (1972).

"6. Whether there exists any procedure by which an officer may know of adverse effectiveness reports and may challenge them prior to their consideration by a promotion selection board, and if such a procedure exists, when it took effect.

"7. Whether a Correction Board has afforded a sufficient remedy for career injury caused by an improper effectiveness report, if it merely removes such report from an officer's selection file, without providing, for the information of later selection boards, any explanation of previous passovers, if any, that may have been caused by such improper report, and of gaps in the apparent service record left by the removal thereof.

"8. Whether, where the court deems plaintiff deserving of relief, the remedy properly should take the form of either plaintiff's reinstatement to active duty; the court's remand of the case for further consideration by the Secretary of the branch of service concerned, or by the Correction Board for that service, or by a specially constituted selection board for that service, or by some other agency; or some other form of relief."

No. 360–75. MARCH 4, 1977

Bernard Carter

Military pay; discharge for unsuitability; medical determination of behavior disorder; procedural defects; invalidity of discharge; laches.—On March 4, 1977 the court entered the following order:

David F. Addlestone, attorney of record, for plaintiff.

Stephen G. Anderson, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

Before Davis, *Judge*, Presiding, Cowen, *Senior Judge*, and Skelton, *Judge*.

"Plaintiff, a former Army private, claims that his military discharge for unsuitability under AR 635–212 (in October 1969), somewhat less than twelve months before his enlistment would have expired, was invalid for procedural deficiencies. Both parties have moved for summary judgment and oral argument has been had.

"In September 1969 plaintiff was referred for psychiatric examination and evaluation for possible administrative separation under AR 635–212. The psychiatrist (Dr. Sergio Henao) found that '[t]here is no evidence of psychiatric disease or defect' and also stated that '[p]sychiatric clearance is granted for whatever administrative action is deemed appropriate by the Command.' Thereafter plaintiff was advised by his commanding officer that the latter would recommend plaintiff's separation under AR 635–212 for unsuitability. Plaintiff signed a statement, after being advised by military counsel, waiving his rights to consideration by and personal appearance before a board of officers and to representation by counsel, and indicating that he understood the potentially adverse consequences of a general discharge (under AR 635–212) under honorable conditions. The next day plaintiff's military counsel wrote the commanding officer recommending a general discharge, the lesser of the two types of separation authorized under AR 635–212 for unsuitability. Plaintiff's discharge for unsuitability under AR 635–212 for a 'character and behavior disorder' was approved late in September 1969 and was effected on October 6, 1969. This suit was filed on October 3, 1975.

"At the outset defendant raises laches since the action was begun only three days before the six-year limitations period would have ended. We reject that defense, on the authority of *Rifkin v. United States*, 209 Ct. Cl. 566, 594–5 (1976), *cert. denied*, 429 U.S. 1098 (1977), and *Chappelle v. United States*, 168 Ct. Cl. 362 (1964), because plaintiff has limited his claim for back pay to the less than one year which elapsed before the end of his enlistment in 1970—a span of time for which he would have been entitled to recover had he brought a successful suit more promptly. At

least with respect to that period, defendant has clearly not been prejudiced by the delay in filing suit. The only potential prejudice would be in the possibly fading memory of the psychiatrist with respect to his intention in making his report. But defendant took the deposition of Dr. Henao and it appears to us from that deposition (which is in the papers before us) that, first, the doctor would probably not have had any better recollection of his examination of plaintiff if this suit had been filed in 1970 or 1971 instead of 1975, and, second, he was in any event under no misapprehension as to the meaning of his report, *i.e.* that he had *not* found a character or behavior disorder.

"On the merits, we see two significant procedural defects in plaintiff's discharge proceedings. The first is that the applicable regulation, AR 635–212, provided that, in the case of a discharge for unsuitability on the basis of specified character and behavior disorders, such a disorder should be 'as determined by medical authority' (a psychiatrist if available). The only such 'medical authority' involved in plaintiff's case was the psychiatrist, Dr. Henao, and far from determining that any such character or behavior disorder was present he found affirmatively that 'there is no evidence of psychiatric disease or defect.' Defendant attempts to ferret out an implicit finding of a character or behavior disorder from the psychiatrist's final and general recommendation that 'psychiatric clearance is granted for whatever administrative action is deemed appropriate by the Command.' This very strained interpretation is contrary to the plain meaning of the medical report and, in addition, was flatly rejected by the report's author, Dr. Henao, in his deposition. It follows that there was a failure to comply with the requirement of AR 635–212 that a discharge for unsuitability on the ground of a specified character or behavior disorder had to have as a prerequisite a medical determination to that effect.[1]

[1] In a very questionable *ex parte* proceeding, instigated after both motions for summary judgment had been filed, by an officer in the Litigation Division of the Office of the Judge Advocate General, the Army Discharge Review Board *sua sponte* held (at the end of September 1976) that there was "technical error" in the psychiatrist's failing to find a character or behavior disorder but that "there is sufficient data in the military record to substantiate that Mr. Carter was in fact appropriately classified as having a character and behavior disorder." However, recognizing "that there was not strict compliance with the letter of the regulation,"

"The second deficiency in the discharge proceedings was that the military officer designated to counsel plaintiff took it upon himself[2] to recommend that plaintiff be granted a general discharge (the lesser of the two discharges, honorable or general, which could be granted for an unsuitability discharge on the basis of a character or behavior disorder). A gratuitous recommendation of this type is akin to an argument by a defense counsel at a court-martial for a punitive discharge for his client, a plea which has several times been condemned by the Court of Military Appeals. *See United States v. Mitchell*, 16 U.S.C.M.A. 302, 36 CMR 458 (1966), and cases following. A counsel whose function is to help the serviceman in a discharge situation should not engage in such disloyal and injurious conduct.

"For these reasons we hold that plaintiff's discharge was invalid and must be set aside. *See Sofranoff v. United States*, 165 Ct. Cl. 470 (1964); *Middleton v. United States*, 170 Ct. Cl. 36 (1965); *Conn v. United States*, 180 Ct. Cl. 120, 376 F.2d 878 (1967); *Russell v. United States*, 183 Ct. Cl. 802 (1968); *Reale v. United States*, 188 Ct. Cl. 586, 413 F.2d 556 (1969); *Cason v. United States*, 200 Ct. Cl. 424, 471 F.2d 1225 (1973). Accordingly, plaintiff is entitled under the usual rule to recover back pay and allowances to the end of his then enlistment, less civilian earnings.[3]

"Defendant invokes *Carter v. United States*, 206 Ct. Cl. 61, 509 F.2d 1150 (1975), as supporting a determination that in any event plaintiff could and would have been

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the Board changed the reason for discharge to "Determination of service secretary." The character of the original discharge was sustained.

Although we do not agree with the Board that "there was compliance with the spirit and intent of the regulation [though not the letter]," the Board's action in changing the reason for the discharge confirms our conclusion that the discharge given in 1969 was invalid under AR 635–212.

[2] There was no requirement that he make any recommendation as to the nature of the discharge.

[3] Although it moved for summary judgment, the Government later suggested that there are factual issues warranting trial. We find the existing record wholly adequate for disposition in plaintiff's favor. It is perfectly plain both that the Army violated its own regulation and that the military counsel acted improperly. As for the defendant's belated claim that plaintiff might be estopped because he wished to get out of the service, the defense of estoppel was not pleaded and the Government has shown little or nothing to suggest that plaintiff misled the Army to its detriment.

discharged in October 1969 in proper form, on proper grounds, and by proper procedures—thus depriving him of all right to back pay. *Carter*, which acknowledged the usual rule, was, as the court also recognized, a very special case with circumstances far different from those now before us (including 'Captain Carter's mental disability at the pertinent period, as officially determined and as asserted by himself in his petition' and 'his recurrent troubles with the civilian law, including convictions and prolonged confinement in prison'). There is no comparable basis of substance in the present case for refusing to apply the general rule; for us to determine that plaintiff would necessarily have been discharged on some other ground in October 1969, even though there was no adequate basis for an unsuitability discharge for a character or behavior disorder, would be bare speculation.[4]

"The last issue concerns the character of the discharge. Plaintiff asks us to order that the discharge be recharacterized as honorable. This is, however, a matter within the Army's discretion. Plaintiff's military record was not so bad as to automatically bar a fully honorable discharge under the pertinent standards, but neither was it so good as to compel one. Because his military record fell into that in-between zone, we must leave it to the Army to decide what kind of discharge (honorable or general) is called for. The Army should determine, as best it can, what character of discharge plaintiff would have received if he had fully served out his enlistment. We intimate no position on the appropriate characterization of the discharge but we also hold that the Discharge Review Board's recent upholding of the characterization of the original October 1969 discharge is in no way binding with respect to the characterization of the discharge to be awarded (as a result of the present litigation) as of the end of the enlistment.

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's motion for summary judgment is denied, plaintiff's motion for summary judgment is granted to the extent that

[4] In that respect we differ from the apparent conclusion of the Army Discharge Review Board (*see* footnote 1 *supra*) that plaintiff would have been discharged in October 1969 even if there had been proper compliance with the relevant regulations.

plaintiff is entitled to back pay and allowances (less civilian earnings) to the end of his enlistment, and also to a recharacterization by the Army of his discharge and an updating of the discharge as if he had served his full enlistment. Judgment is entered to that effect. The amount of recovery will be determined under Rule 131(c).

"IT IS FURTHER ORDERED AND CONCLUDED that the Secretary of the Army, acting through the appropriate officials or entities, shall correct plaintiff's discharge to show its date as if plaintiff had served his full enlistment, and shall also consider and determine the appropriate and lawful characterization of that discharge."

No. 425–75. MARCH 4, 1977

Elmer J. Leland

Civilian pay; reclassification; administrative discretion.—On March 4, 1977 the court entered the following order:

Elmer J. Leland, Pro se.

Marc J. Fink, with whom was *Assistant Attorney General Rex E. Lee,* for defendant. *Russell W. Koskinen* and *Carol J. Hansen,* of counsel.

Before DAVIS, *Judge,* Presiding, KASHIWA and KUNZIG, *Judges.*

"Plaintiff, a regional traffic operations engineer employed by the Federal Highway Administration in its Portland, Oregon, office, challenges the Civil Service Commission ('CSC') reclassification of his position from a GS–810–14 to a GS–810–13 as a breach of employment contract by the defendant or, alternatively, as an arbitrary and capricious action on the part of the CSC Regional Director. Plaintiff seeks reversal of the reclassification and back pay commensurate with a GS–14 classification. This case comes before the court on defendant's motion for summary judgment and on plaintiff's cross motion for partial summary judgment. There is no genuine issue as to any material fact.

"Plaintiff's assertion of a contractual right to employment with the Government is wholly inconsistent with a long line of cases which hold that federal employees are appointed officials not subject to contract. *Taylor* v. *Beckman*, 178 U.S. 548, 577 (1900); *Crenshaw* v. *United States*, 134 U.S. 99, 105 (1890). This court specifically so held in the recent case of *Applegate* v. *United States*, 211 Ct.Cl. 380 (Order of June 27, 1975), wherein we stated:

> * * * We * * * reaffirm that employment (and the perquisites thereof) by appointment with the Government does not create a contractual relationship. [Citations omitted.]

See also Hopkins v. *United States*, 206 Ct. Cl. 303, 513 F.2d 1360 (1975), *partially vacated and remanded*, 427 U.S. 123 (1976); *Urbina* v. *United States*, 192 Ct. Cl. 875, 428 F.2d 1280 (1970).

"With relation to plaintiff's assertion that the CSC Regional Director acted arbitrarily and capriciously while applying classification grade standards to plaintiff's position, the extent to which this court may review that reclassification is limited. The sole function of the court is to determine whether or not the contested CSC action constituted arbitrary and capricious conduct. *Guiness* v. *United States*, 149 Ct. Cl. 1, 6, *cert. denied*, 363 U.S. 819 (1960); *Holman* v. *United States*, 181 Ct. Cl. 1, 8, 383 F.2d 411, 415 (1967). Given those parameters of our jurisdiction, we have examined the record and do not find that the reclassification of plaintiff's position by the CSC was either arbitrary or capricious, but, rather, we find that it is in fact supported by substantial evidence.

"Essentially, plaintiff's claim of arbitrariness in the reclassification proceedings is twofold. Firstly, plaintiff maintains that the reclassification of his position prior to reclassification of the positions of the highway engineers in the eight other Federal Highway Administration regions constitutes unequal treatment which violates the requirement of equal pay for substantially equal work, 5 U.S.C. § 5101(a)(1) (1970). Secondly, plaintiff alleges that the job description for his position and the job which he is actually performing are inconsistent.

"As to plaintiff's initial contention, plaintiff assumes that his position is similar to the positions of the highway engineers in the other Federal Highway Administration regions. Such an assumption is simply not supported by the record. The record indicates, specifically the March 3, 1976, letter from the CSC to the Federal Highway Administration, that the similarity of plaintiff's position to that of other highway engineers is under investigation.

"Nevertheless, even if subsequent to investigation it were determined that all Federal Highway Administration highway engineers performed identical functions, it would not follow that the CSC would be required to effect simultaneous reclassifications. The timing of the reclassifications would be within the discretion of the CSC. The fact that the CSC has reclassified one position without simultaneously reclassifying all others does not necessarily reflect arbitrary and capricious conduct. *See Olshanski* v. *United States,* No. 72 Civ. 2346 (S.D.N.Y. April 14, 1976). In another suit involving the application of promotions to individuals in similar positions at varying times, the court held:

> * * * that there are certain functions that must be executed after the final standards are promulgated and before all persons to be affected receive their raises, *i.e.,* the actual application of the standards to the currently structured positions of employees currently holding those positions. Obviously, these functions will vary in time requirements from situation to situation. [Brech v. *United States Immigration and Naturalization Service,* 362 F.Supp. 914, 919 (S.D.N.Y. 1973).]

It is therefore evident that the duty of the CSC is not to compare simultaneously all similarly termed positions for similarity of job requirements when undertaking classification of one such position. Rather the obligation of the CSC is to ensure that the classification of any particular position is consistent with the position description and job requirements of that one position and that classification of other similar positions be taken within a reasonable time. It is precisely that obligation to which the CSC has adhered in the case of plaintiff. Defendant has addressed itself to

the reclassification action pursued by the CSC with regard to other regional highway engineers. Defendant's exhibits demonstrate that the highway engineer positions in the other regions already have been or shortly will be reviewed. The record fails to show any dilatory action by either the Federal Highway Administration or the CSC to implement reclassification within a reasonable time.

"As to plaintiff's second contention, the question of whether plaintiff is properly classified is within the statutory authority of the CSC to decide.

> * * * Congress has granted to the Civil Service Commission broad authority in regard to the classification of Government employees. 5 U.S.C. § 5112 (1970) specifically authorized the Commission to:
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> * * * * *
>
> (3) decide whether a position is in its appropriate class and grade; and
>
> (4) change a position from one class or grade to another class or grade when the facts warrant.
>
> These are functions which, by their very nature require discretionary judgments as to the level of difficulty or complexity of work, and the degree of attendant responsibility. [*Bookman* v. *United States*, 197 Ct. Cl. 108, 116, 453 F.2d 1263, 1267 (1972).]

Plaintiff, in his challenge of the CSC reclassification proceedings, has the burden of establishing 'arbitrariness in and lack of support for, the administrative determinations.' *Albert* v. *United States*, 194 Ct. Cl. 95, 100, 437 F.2d 976, 979 (1971). This burden plaintiff has failed to meet. The distinctions which led the CSC to reclassify plaintiff's position from a GS–14 to a GS–13 are clearly detailed in the administrative record. They were determined in the course of an exhaustive review which included an advisory opinion from the Bureau of Personnel Management Evaluation and two complete desk audits.

"It is not for this court to make its own determination as to the proper classification of plaintiff's position. *Barger* v. *United States*, 170 Ct. Cl. 207, 214 (1965). It is, rather, for this court to determine the reasonableness of the CSC's classification. Insofar as plaintiff has failed to establish that the reclassification of his position was either arbitrary

or capricious, the action by the CSC must be sustained. Therefore,

"IT IS ORDERED that defendant's motion for summary judgment be and is hereby granted, that plaintiff's cross-motion for partial summary judgment be and is hereby denied and that the petition be and is hereby dismissed."

No. 258–73. APRIL 1, 1977

Morey Machinery Co., Inc.

Contracts; validity of contract; mistake in designation of proposed procurement; advertised v. negotiated procurement.—The Government, through administrative error, issued an advertised solicitation which had been incorrectly designated as a negotiated procurement for two mechanical metal cutting shapers. Plaintiff, in response to the solicitation, submitted an offer that allegedly reflected an incorrect price. Neither error was corrected at the time of contract execution. Performance under the contract has been completed and plaintiff now seeks reformation of the contract or, in lieu thereof, its rescission, and, as part of either form of relief, asks also that payment be measured against the reasonable value of the equipment that was delivered to the Government under the contract rather than by the contract price. On August 4, 1976 Trial Judge John P. Wiese filed a recommended decision (reported in full text at 22 CCF ¶ 80514) in which he concluded that plaintiff is not entitled to any additional payment under its contract save for $390 which defendant agrees is still due and owing. Plaintiff entered into a valid, fixed-price contract without ever alerting the Government to the fact (i) that the solicitation had been designated as a negotiated procurement, and, (ii) that it held any reservation of rights on account of this misdesignation or for any other reason. For its part, the Government, at time of contract execution, had no knowledge of its own mistake nor any knowledge that plaintiff intended to accept the contract with a reservation of rights in order to preserve a claimed mistake in bid. On April 1, 1977 the court, sitting as a panel composed of *Judges* DAVIS, SKELTON and KASHIWA,

entered an order affirming and adopting the said recommended decision as the basis for its judgment in this case, and concluded and ordered that plaintiff is entitled to be paid only $390, entered judgment for plaintiff against defendant in that amount, and since plaintiff is not entitled to recover beyond said amount, otherwise dismissed the petition.

No. 28–75. APRIL 1, 1977

Paul J. Savio

Military pay; correction of military records; passover for promotion; administrative discretion.—On April 1, 1977 the court entered the following order:

Charles M. Munnecke, attorney of record, for plaintiff. *Thomas H. King,* of counsel.

Vincent M. Garvey, with whom was *Acting Assistant Attorney General Rex E. Lee,* for defendant.

Before NICHOLS, *Judge,* Presiding, COWEN, *Senior Judge,* and BENNETT, *Judge.*

"This military pay claim is before the court on motions of the parties for summary judgment. The first petition, filed January 31, 1975, sought (1) reinstatement and retroactive promotion with back pay, (2) alternatively, a court order for the correction of an efficiency report by withdrawal thereof and nullification of a passover, or (3) as a further alternative, a direction to the Secretary of the Army to reenlist plaintiff. By order of the court on October 17, 1975 (207 Ct. Cl. 1039), counts (1) and (3) of the petition were dismissed, on defendant's motion, for failure to state claims on which the court could grant relief. Plaintiff was given opportunity to amend his petition to include a demand for reinstatement and money damages under the records correction count, number two.

"Plaintiff amended his petition on November 17, 1975, alleging (1) that denial by the Army of his request for withdrawal of the efficiency report for the period April 12, 1967, to April 11, 1968, was arbitrary, erroneous, and

contrary to law and fact, and (2) failure to withdraw the report made for irregularities in the selection board proceedings which should void the nonselection action. Plaintiff concludes from this that he is entitled to reinstatement as a major, AUS, with appropriate back pay from the date of plaintiff's termination on November 1, 1974. Defendant has moved for summary judgment and plaintiff, in responding thereto, has filed a cross-motion for summary judgment. The issues have been briefed and argued.

"Plaintiff, by all accounts a dedicated officer of high caliber, a West Point graduate, entered on duty June 8, 1960, and was regularly promoted until twice passed over for selection to the grade of permanent major by selection boards which met on or about May 1, 1973, and April 22, 1974. By reason of the second passover plaintiff was separated from the Army.

"On March 25, 1974, plaintiff appealed his Officer Efficiency Report (OER) for the period mentioned above, during which he was in combat in Vietnam, asking that it be removed from his selection folder. This report, which is in evidence, spoke in highly complimentary terms of plaintiff in the narrative portion, but gave him an overall 'value to the service' rating of only 60 on a scale of 100. Elsewhere on the report he was recommended for promotion along with his contemporaries. Plaintiff was not aware of the nature of this report until he authorized a friend to examine the record in June 1973, after plaintiff was first notified of nonselection. He wrote defendant for a copy, which was refused. He eventually saw it in June 1974. Plaintiff in his appeal pointed out that the numerical rating was inconsistent with the narrative on the OER and that he had not been given counseling by his rater or indorser. Apparently this was not an 'adverse report' under Army regulation 623–105, paragraph 1–3*j* (31 Oct. 1968), so that plaintiff would have been entitled to see it at a time when he could have offered rebuttal to it before damage was done to his career. However, the effect of the report, as a practical matter, was indeed prejudicial and adverse, and plaintiff says it was the proximate cause which terminated his military career. Nevertheless, his appeal was rejected.

"Plaintiff appealed again on July 18, 1974, and submitted supporting certificates of achievement, commendation statements attesting to his superior manner of performance, and letters from his battalion commanding officer and indorser. An Army special review board rejected the appeal.

"On September 30, 1974, plaintiff submitted a letter from his rater on the OER in a third appeal. This letter from Lt. Col. William F. Doherty indicated that he did not believe when he rated plaintiff that the OER would damage plaintiff's career, that he had rated plaintiff above average, that he had given slight personal attention to plaintiff's performance of duties, and that he was guilty of omissions from his report on plaintiff, but that he had been cautioned by his own superiors not to over-inflate numerical ratings on OERs. Colonel Doherty stated further: '*I also hereby attest that your OER of 11 April 1968 should be withdrawn from your military record* because it failed to truly establish the high regard I felt for the high quality of your service in Vietnam, and your outstanding character.' [Emphasis in letter.] Again the appeal was rejected, plaintiff being advised: 'No basis exists for amendment or invalidation of the report in question in that the information you presented does not constitute material evidence that the report is administratively incorrect or substantively inaccurate.'

"Plaintiff made a fourth and final appeal on October 13, 1974. At this time he pointed out his inability to provide statements from third parties who were in official positions which enabled them to observe directly the manner in which plaintiff performed his duties, because his only official dealings with an American commander were with Lt. Col. William F. Doherty, who admitted his inattention to plaintiff's Ordnance Company, except on rare occasions. As a military adviser plaintiff also had dealings with the Vietnamese. He submitted a Vietnamese Technical Service Medal, First Class, attesting to the Vietnamese approval of his performance. The appeal was again rejected. Plaintiff did not appeal to the Army Board for the Correction of Military Records, but filed suit instead.

"The question we must consider is whether there was any legal error which would entitle plaintiff to a money judgment based on violation of a federal statute which 'can fairly be interpreted as mandating compensation by the Federal Government for the damage sustained.' *United States* v. *Testan*, 424 U.S. 392 (1976), citing *Eastport S.S. Co.* v. *United States*, 178 Ct. Cl. at 607, 372 F.2d at 1009 (1967). Ordinarily we can upset a selection board decision only where a board is illegally constituted, *Ricker* v. *United States*, 184 Ct. Cl. 402, 396 F.2d 454 (1968), *Henderson* v. *United States*, 175 Ct. Cl. 690 (1966), *cert. denied*, 386 U.S. 1016 (1967), or it has had improper matters presented to it or there has been a violation of regulations or statutes. *Brenner* v. *United States*, 202 Ct. Cl. 678 (1973), *cert. denied*, 419 U.S. 831 (1974). Further, it is so well settled in this court as not to merit additional discussion or citation of authority that ratings and promotions are discretionary matters in which the court will scrupulously not intervene unless relief is mandated by law.

"It is plaintiff's position that the offending OER was so incompatible with plaintiff's actual performance of duty, as shown by other OERs, that its inclusion in plaintiff's record before the selection boards was legal error as well as an actionable abuse of discretion, mandating removal of the passovers. But, when the selection boards considered plaintiff for promotion, they had no inkling of any possible problem with the OER and cannot be faulted for their action taken in good faith. However, plaintiff argues that the subsequent letter of the rating officer, Lt. Col. William F. Doherty, shows that the OER was incorrect and plaintiff's administrative appeal should have afforded relief to him. This court has held that such after-the-fact letters from rating officers who in retrospect state that in their opinion they rated a particular officer too low do not raise a triable issue of fact for the court as to whether there has been an abuse of discretion. We do not substitute our judgment for the military in evaluating that kind of evidence. *Tanaka* v. *United States*, 210 Ct.Cl. 712 (1976), *cert. denied*, 430 U.S. 955 (1977). There are obvious reasons for attaching more weight to the original evaluation. We conclude then that each selection board that passed over

plaintiff for promotion had a proper record before it, so far as facts were then available to it. There is no authority supporting any other possible conclusion.

"Since we find no legal error and the court is not in the promotion business or otherwise authorized to run the Army, we conclude that plaintiff has not stated a claim upon which relief can be granted. This is not to say we hold defendant's treatment of the plaintiff to have been in all respects fair and just. Assuming without finding that the offending OER was a missile that destroyed plaintiff's military career by blind mischance, it is for the Services to determine to what extent they are able to operate the selection system in such a way as to preclude such mischance. To some extent probably, an upwardly mobile career cannot be wholly shielded from such mischance, in the military, any more than in the arts, the media, industry, finance or law. This court cannot make perfect a system that the military themselves in their regulations allow to exhibit imperfections, which may or may not be inherent in the nature of the system. Since plaintiff did not resort to the Army Board for Correction of Military Records, which has power to correct injustices not amounting to legal error under 10 U.S.C. § 1552 (1970), we need not consider the posture the case would have if that body had been applied to and had denied relief. Such issues will be considered in other cases now pending.

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is granted and plaintiff's cross-motion for summary judgment is denied. The petition is dismissed."

No. 90-75. APRIL 1, 1977

Standard Dredging Corporation

Contracts; finality of administrative findings on question of fact; changed conditions; worksite; sea conditions.—On April 1, 1977 the court entered the following order:

Richard G. Kline, attorney of record, for plaintiff. *Beveridge, DeGrandi, Kline & Lunsford,* of counsel.

Edward J. Friedlander, with whom was *Assistant Attorney General Barbara A. Babcock,* for defendant.

Before NICHOLS, *Judge,* Presiding, KUNZIG and BENNETT, *Judges.*

"This case is before the court on defendant's request for review of Trial Judge C. Murray Bernhardt's opinion, filed September 16, 1976, reversing in an appeal brought by plaintiff under the Wunderlich Act, 41 U.S.C. §§ 321, 322 (1970), a decision of the Corps of Engineers Board of Contract Appeals, 69–1 BCA ¶ 7579, and finding plaintiff entitled to an equitable adjustment under the Changed Conditions clause of its contract with the Government. Upon consideration of defendant's request and brief, together with plaintiff's opposition thereto, after oral argument, we find that the trial judge's opinion cannot be sustained, and we render judgment for defendant on the basis of the board's decision.

"In 1961 plaintiff was awarded a competitively bid, fixed-price contract by the Army Corps of Engineers, acting on behalf of the United States, to dredge certain portions of Del Mar Harbor at Oceanside, California. The contract's Special Condition 4 (SC–4) warranted that '[t]he working season is the entire year, but work may be interrupted by unfavorable weather conditions for short periods in any month,' and that '[w]ave action is usually not severe and the currents are moderate.' When plaintiff undertook to perform its contract in 1962 and 1963, it experienced rough wave conditions that forced it to suspend dredging operations for all or parts of 41 days. Plaintiff filed with the contracting officer a claim for an equitable adjustment under the Changed Conditions clause of its contract, contending that the wave conditions it encountered, resulting in the work suspension, were contrary to those warranted in SC–4. The contracting officer denied plaintiff's claim, and plaintiff appealed to the board.

"After a hearing, the board rejected plaintiff's appeal. It concluded, from the testimony of plaintiff's expert witness and from the contract language, that plaintiff's problem, rather than being one of changed conditions compensable

under the contract, 'was nothing more than the familiar one from time immemorial of the unpredictability of the sea.' The board found that the year and the time of year in which plaintiff dredged in harbor areas exposed to the sea surge were unfortunate for plaintiff, for rough wave conditions were then experienced. However, the board thought this not to require an equitable adjustment, both because the scheduling of work was the responsibility of—and the risk necessarily assumed by—the contractor (especially in light of the Government's agreement, early in the contract performance period, to allow the contractor to decide the sequence of areas to be dredged), and because the sea conditions were largely unpredictable. Continuing along the latter theme, the board also held that plaintiff had no reason to expect, as a legal matter, better sea conditions than it encountered, for the board interpreted SC–4 as promising very little: 'The assertion that wave action is usually not severe implies that there are times when it may be.' Finally, the board rejected the argument that the sea conditions were so hazardous as to make the contract constructively impossible of performance, pointing out that the Government relieved plaintiff from the obligation of dredging the small area on which the impossibility claim was based, that the harbor had been dredged successfully before, and that one of the previous dredging contractors had bid against plaintiff for the contract at issue, not considering from its own experience that the task was impossible.

"The board's findings of fact have not been shown to be wanting in support from the evidence, or otherwise arbitrary and capricious. Its legal conclusions are correct, in our view, and therefore the board's entire opinion is hereby adopted by the court and made the basis for our judgment, in defendant's favor. We particularly emphasize that the statements in SC–4, predicting wind and wave to be favorable to dredging operations at times, and not so good at times, actually warrant hardly any sea condition. Their reservation of the possibility of poor weather conditions for periods in each month simply came true for the months in which plaintiff attempted to dredge the exposed areas of the harbor. Their assertion that wave

action would 'usually' not be 'severe' speaks in terms that are not absolute, conveying meaning in themselves, but that are comparative only, though the standard for the comparison is nowhere apparent. We are left with the conclusion that the terms are so indefinite that they may not reasonably be construed as promissory, without more. One would think that a contractor, confronted with such statements, would have made thorough on-site inquiries of his own, particularly if he had never before dredged in the specific area, as was the case with plaintiff. However, not only did this plaintiff not undertake to determine (before dredging) what the 'usual' sea conditions were at Oceanside, it in fact made so cursory an inspection of the location that it may be considered not to have looked at the proposed operations site at all. In these circumstances, plaintiff having made no attempt to ascertain the standard against which to measure the infrequency and severity of the conditions it encountered, or otherwise to resolve the patent ambiguities in the SC–4 language if such is to be read as promissory, the claim must fail.

"The trial judge's criticisms of the board's opinion are not well taken. His view, first, that the board inferentially faulted plaintiff for not moving its dredge about with an impossible alacrity, in order to avoid the rough seas, simply misperceives the board's point in mentioning the matter. The board, to the contrary, understood the difficulty of relocating the dredge at any particular time was a risk to be assumed by the contractor. The contractor here had no duty to cause its dredge to shuttle about, nimbly dodging the periodically rough waves, but rather it bore the risk that wave action would impair operations where it had located the dredge, in accordance with its own work schedule.

"The trial judge's legal conclusion that abnormal sea conditions were encountered by plaintiff, inconsistent with the statements in SC–4, is based on both unauthorized fact-finding on his part, and an interpretation of the contract language at odds with the board's and our own. The board rested its factual determination regarding the unpredictability of the seas, and therefore the absence of a changed condition, on the testimony of plaintiff's expert witness.

The trial judge does not take issue with this, but comes to a different conclusion by finding additional facts, not mentioned in the board's opinion, on the average wave height at Oceanside during the periods of dredging in exposed areas, the wave height that would impede dredging operations, and the amount of time spent in dredging the exposed areas. In finding these additional facts, the trial judge exceeded his authority, as defined by the review standards prescribed in the Wunderlich Act, *United States* v. *Carlo Bianchi & Co.*, 373 U.S. 709 (1963), as the board record did not fully support or require such findings and none could be made which were inconsistent with it. *International Tel. & Tel. Corp.* v. *United States*, 206 Ct. Cl. 37, 47 n. 9, 509 F. 2d 541, 546 n. 9 (1975). Were such findings thought necessary to a proper resolution of the case in this court, a remand of the cause to the board with instructions to make the further findings would have been the course to follow, under the remand authority of Pub. L. 92–415, 28 U.S.C. § 1491 (Supp. V, 1975). However, in view of our discussion of the nature and scope of the SC–4 warranty, *supra*, such a disposition is not needed. The trial judge's interpretation of the content of SC–4, pledging some order of wave behavior at variance with what the contractor encountered, must be considered erroneous for the reasons stated in the second preceding paragraph.

"For the reasons hereinbefore stated, the trial judge's opinion cannot be sustained, and the board's ruling, for want of any showing that it is arbitrary and capricious, lacking in substantial evidence, or legally erroneous, must be considered final.

"IT IS THEREFORE ORDERED that plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted, and the petition is dismissed."

No. 189–76. APRIL 1, 1977

Ronald K. Bradley

Contracts; lease; year-term lease with annual option to renew; termination of lease.—On April 1, 1977 the court

sitting as a panel consisting of NICHOLS, *Presiding Judge,* COWEN, *Senior Judge,* and BENNETT, *Judge,* entered the following order:

"This case is before the court on defendant's motion for partial summary judgment, filed October 15, 1976, and plaintiff's cross-motion for partial summary judgment, filed November 15, 1976. Plaintiff entered into a contract on October 27, 1972, to lease a dining club car concession from defendant's agent, the Alaska Railroad. The lease term was 'for a period of one (1) year, effective November 1, 1972, with the right to extend the lease term from year to year for a maximum of five (5) years . . . .' The lease provisions also permitted either party to terminate the contract 'at any time . . . on ninety (90) days' notice in writing to the other party . . . .'

"Plaintiff commenced service under the club car concession as contemplated under the lease. However, a number of complaints soon arose as to plaintiff's service, such that defendant, while recognizing the fact that there had been no breach of contract by plaintiff, nevertheless determined that it would terminate the lease agreement. On September 12, 1973, the defendant notified plaintiff that it was terminating the lease as of December 13, 1973, a date which was one month into the second year of the lease but 92 days after the notice of termination. The lease was in fact terminated on the date specified in the notice.

"Plaintiff brings its suit on two grounds, but only one ground is before the court in these cross-motions. It is plaintiff's contention that the lease is a year-term contract, renewable annually at the option of the parties. Holdover of the lease into a new year, in plaintiff's view, automatically extends the term of the lease for that entire year. As for the termination clause, plaintiff would have us construe its meaning to constitute only a *method* of termination; that is, as a requirement that the parties give 90-days' notice, but within the one-year term.

"We cannot accept such an interpretation as reasonable. In effect, plaintiff would have us interpret the language '*at any time* . . . on ninety days' notice' to read as if it said 'at any anniversary of the contract on ninety days' notice.' Such a reading would render meaningless the unambigu-

ous term 'at any time,' and this would be in contravention of our many holdings that all contract provisions are to be given effect and no provision rendered meaningless. *United Pacific Ins. Co. v. United States*, 204 Ct. Cl. 686, 693–94, 497 F.2d 1402, 1405 (1974); *Jamsar v. United States*, 194 Ct. Cl. 819, 826, 442 F.2d 930, 934 (1971); *Hol-Gar Mfg. Corp. v. United States*, 169 Ct. Cl. 384, 351 F.2d 972 (1965).

"Plaintiff also argues that if the termination clause is not construed as merely a *method* of termination subject to the general one-year term, then the termination clause and the annual-term clause are inconsistent; plaintiff would have us construe this alleged inconsistency against the defendant, as the drafter of the lease contract. However, we do not agree that the two provisions in question are inconsistent. The first lease provision, which sets forth a one-year lease with annual option to renew, is a very general provision setting forth the normal procedure for extending or terminating the agreement. But superimposed upon this general provision is the specific termination clause, which provides both parties an additional right to terminate the contract before the natural lapse of the year term. It is long-established law that specific contractual provisions take precedence over general contractual provisions to the extent that any inconsistency exists between them. *United Pacific Ins. Co., supra*, at Ct. Cl. 694, 497 F.2d 1405; *Dravo Corp. v. United States*, 202 Ct. Cl. 500, 504, 480 F.2d 1331, 1333 (1973); *Kenneth Reed Corp. v. United States*, 201 Ct. Cl. 282, 290, 475 F.2d 583, 587 (1973).

"Moreover, only if the termination provision is viewed as a specific departure from the general one-year term does the ninety-day notice requirement make sense; it is *because* the termination procedure is a departure from normal procedure that such notice is necessary. And as noted *supra*, the court must interpret a contract to give meaning to every term in the contract, when such an interpretation is possible.

"We think the only reasonable interpretation of this lease contract is one which gives the termination language its plain meaning. Defendant terminated the contract 'at any time,' giving the required notice to plaintiff. Defendant perfectly conformed to the lease provisions in this respect,

and hence its action in no way constituted a breach of contract.

"IT IS THEREFORE ORDERED that defendant's motion for partial summary judgment is granted and plaintiff's cross-motion is denied. Count I of plaintiff's petition is dismissed. The case is remanded to the Trial Division for trial or other proceedings on Count II of plaintiff's petition."

On June 27, 1977 on stipulation of the parties the petition was dismissed.

No. 338–76. APRIL 1, 1977

Harold E. Dowler

Judgments; prior adjudication; res judicata.—Plaintiff seeks money damages for alleged improper separation from the Air Force, reinstatement and promotions. On April 1, 1977, on defendant's motion to dismiss plaintiff's petition, the court entered an order concluding that plaintiff's action in this court is governed by the doctrine of *res judicata* and is barred by the decision in *Dowler* v. *Schlesinger,* 384 F. Supp. 39 (D. Md. 1974). (See *Sunshine Coal Co.* v. *Adkins,* 310 U.S. 381, 403 (1940); *Commissioner* v. *Sunnen,* 333 U.S. 591, 597 (1948); and *Container Transport Int'l* v. *United States,* 199 Ct. Cl. 713, 468 F.2d 926 (1972), ordering that plaintiff is not entitled to recover in this court, and dismissing the petition. Plaintiff's motion for rehearing and suggestion for rehearing *en banc* were denied May 27, 1977.

No. 411–75. APRIL 15, 1977

Essie I. Bohannon

Pleading and practice; interrogatories, adequacy of responses to interrogatories; dismissal of action; taking claim.—Plaintiff seeks just compensation for an alleged taking of certain real estate values by reason of defendant's construction of a water impoundment structure on the Arkansas River. After filing its answer, defendant addressed various interrogatories to plaintiff under Rule

73(a); plaintiff's attorney responded and/or commented on the interrogatories; defendant moved under Rule 73(d) for an order compelling plaintiff to answer certain of the interrogatories; plaintiff responded contending generally that in substance the earlier responses were sufficient; the trial judge ordered plaintiff to furnish defendant full and complete answers to the interrogatories under pain of sanctions authorized by Rule 76(b)(2) for failure to do so; plaintiff purported to comply with the trial judge's order; and defendant filed a motion to dismiss contending that in various specified particulars plaintiff failed to adequately respond to all of the interrogatories. On December 13, 1976 Trial Judge George Willi filed a recommended decision concluding that the record suggests that plaintiff's failure to respond more informatively to the interrogatories, as well as to the pretrial order, was attributable to the nonexistence of facts necessary to establish liability rather than to a tactical or deliberate refusal to disclose such facts; that the convening of a trial or initiation of further proceedings would amount to an unwarranted imposition of time and expense burdens on plaintiff, defendant and the court; that on the present state of the record defendant could not responsibly be required to proceed to trial nor was there any indication that the situation was susceptible of the material degree of change that would be necessary to afford defendant responsible notice of the evidence with which it would be confronted in support of the claim that it was undertaking to defend against; and that the petition should be dismissed. By order dated April 15, 1977, the court sitting as a panel consisting of *Judges* DAVIS, SKELTON and KUNZIG, affirmed and adopted the recommended decision as the basis for its judgment in this case, and concluded and ordered that plaintiff is not entitled to recover, granted defendant's motion to dismiss, and dismissed the petition.

No. 536–71. APRIL 26, 1977 and SEPTEMBER 29, 1977

Tubular Aircraft Products, Inc.

Contracts; default termination; waiver of delivery time; failure to make progress.—General Services Administration

terminated for default a contract with plaintiff for the latter's alleged failure to deliver in accordance with the contract's original delivery schedule and for failure to make progress so as to endanger contract performance. Plaintiff seeks damages for alleged breach of contract by the Government. On November 29, 1976 Trial Judge John P. Wiese filed a recommended decision (reported in full text at 23 CCF ¶ 81,327) concluding that the default termination predicated upon plaintiff's failure to have met the requirements of the contract's original delivery schedule is not sustainable. The Government must be held to have affirmatively changed that schedule, or, alternatively, to have waived its right to insist upon performance in accordance with such schedule. Moreover, the Government's continued toleration of delivery delinquencies on plaintiff's part, coupled with the failure to establish any specific delivery dates subsequent to abandonment of the initial delivery schedule, resulted in there being no enforceable delivery schedule either at the time the cure notice was issued or at the time of default termination. The trial judge also concluded that the default termination is sustainable for plaintiff's failure to make progress so as to endanger contract performance. Plaintiff's minimal performance efforts coupled with its perilous financial situation warranted the issuance of a cure notice. Thereafter, plaintiff's failure to advise the Government that corrective action would be taken in order to make performance at levels reasonably commensurate with contract requirements financially possible, justified the default termination. On April 26, 1977 the court, sitting as a panel composed of *Judges* DAVIS, SKELTON and BENNETT, agreed with and adopted the said recommended decision as the basis for its judgment in this case, and accordingly concluded and ordered that plaintiff is not entitled to recover. The court also remanded the case to the trial judge for further proceedings in connection with the trial of the Government's counterclaim. Since plaintiff failed without excuse to raise any defenses to the counterclaim within the time prescribed by the court's Rules, on September 29, 1977 the court ordered that defendant recover $825,332, representing $710,070 in progress payment liability and

$115,262 in default clause liability, and dismissed the petition.

No. 169–75. APRIL 26, 1977

Cory Pools, Ltd.

Pleading and practice; discovery and inspection; production of documents; employment taxes; purpose for which information sought; hearsay rule exception.—On April 26, 1977 the court entered the following order:

Joseph J. Lyman, attorney of record, for plaintiff.

Patricia B. Tucker, with whom was *Acting Assistant Attorney General Myron C. Baum,* for defendant.

Before DAVIS, *Judge,* Presiding, SKELTON and BENNETT, *Judges.*

"Plaintiff asks the court in this employment tax case to review and overturn, pursuant to Rule 53(c)(2)(ii), Trial Judge George Willi's denial of discovery of certain information on third-party income and self-employment tax returns in an order issued on January 25, 1977. This order preceded this court's ruling in *L.A.S. Enterprises, Inc.* v. *United States, ante* at 698 relying upon *Farm & Home Aluminum Products, Inc.* v. *United States,* 211 Ct. Cl. 291 (1976), which allowed discovery of similar information in related circumstances. In refusing plaintiff's discovery request, the trial judge cited the irrelevance and inadmissibility of the information sought, issues not raised in *L.A.S. Enterprises* and *Farm & Home.* He found plaintiff's request wanting in that plaintiff hinged its asserted need for the tax return information on (1) the possibility that plaintiff's alleged employees had already paid the tax assessed against plaintiff, showing that the Commissioner's assessment was excessive on its face and therefore invalid as arbitrary, and (2) the intention to introduce in evidence at trial the alleged employees' characterizations of their relationships with plaintiff, as these appear on the returns, helping to prove that plaintiff was not really their employer. The trial judge rejected both of these grounds for

discovery, stating that (1) information on the amount of the tax paid by others would not be relevant until the quantum stage of the case, which is currently being readied for trial on the liability issue only, and that (2) the returns (or schedules prepared by defendant from them) would not be admissible at trial because they constitute hearsay, and thus are subject to the ban of FED. R. EVID. 802.

"While we conclude that the order now appealed must be vacated, for reasons which follow, we preface those reasons with some observations about plaintiff's contentions. First of all, plaintiff is incorrect that the court's order in *Farm & Home*, later applied in *L.A.S. Enterprises*, mandates reversal of the trial judge's ruling. The *Farm & Home* order did not say that the amount of the self-employment tax paid by the alleged employees was relevant and discoverable in the liability stage of the proceeding, but to the contrary, in its concluding paragraph, the order provided for the release of such information at the quantum stage of the case, to be reached only if the taxpayer is unsuccessful in the first instance. Further, that order did not address the issue of whether the purpose for which the information sought justified the discovery, which is a critical part of the present controversy. Secondly, plaintiff's attack on the trial judge's reasoning regarding the relevance of the amount paid and the admissibility of the returns in evidence must fail on the merits. The trial judge was correct, as the *Farm & Home* order seemed silently to attest by its delayed release of the information, that plaintiff's concern with the amount paid by third parties is at best premature. Plaintiff's entitlement to a credit against its assessment for the tax paid by others is a matter for the quantum stage of the proceeding, at least absent some allegation, not made here, that the third-party payments equal or exceed the Commissioner's assessment against plaintiff and render the liability proceeding futile for the Government. The trial judge properly, we think, dismissed plaintiff's contention that its burden of proof on the counterclaim (plaintiff paid only $780.46 of its assessment, and the Government counterclaimed for the balance of $44,251.10) was different than the refund claimant's usual burden. Plaintiff's argument analogized the counterclaim to a deficiency assess-

ment undergoing a redetermination in the Tax Court, where the taxpayer need only show that the Commissioner's determination was arbitrary in order to have it overturned, unlike the situation with the refund claimant in the District Court or the Court of Claims who must establish the correct amount of the tax. *Helvering* v. *Taylor*, 293 U.S. 507 (1935), *aff'g* 70 F.2d 619 (1934) (L. Hand, *J.*). The trial judge acknowledged the authority of *Taylor* but held it inapposite, since this is still a refund suit—requiring the taxpayer to prove the correct amount of the tax—and since the transactional definition of a cause of action under the excise tax provisions of the Code, allowing suit after only the partial payment plaintiff made here, *Steele* v. *United States*, 280 F.2d 89 (8th Cir. 1960), does not convert this proceeding into a Tax Court-type redetermination. *Cf. Psaty* v. *United States*, 442 F.2d 1154, 1160 (3d Cir., 1971).

"Plaintiff's criticism of the trial judge's evidentiary ruling, calling the information sought by discovery inadmissible hearsay, is equally weak. The criticism centers on the trial judge's refusal to consider the return's declarations about the employment status of the alleged employees to fall within the hearsay exception on 'state of mind' observations, FED. R. EVID. 803(3). However, that rule expressly forbids the exception's use to admit statements to prove the truth of a belief (except as it relates to a declarant's will), which is precisely the purpose for which plaintiff wishes to make use of the returns. Plaintiff offers no good reason why the trial judge's application of Rule 803(3) was erroneous, and points to no other hearsay exception under which the information sought to be discovered could fall for purposes of admission at trial.

"Since the trial judge's rulings on the points placed in issue by the parties cannot be faulted, normally this would require affirmance of the order. However, certain actions and assumptions in the procedural history of plaintiff's discovery request do counsel in favor of vacating the order below and remanding the matter for further consideration by the parties and the trial judge. First, the trial judge's order, apparently in response to the parties' view of the discovery request at that time, treated the request as one

for production of the entire tax returns of the alleged employees, rather than for production of certain information on the returns. Thus, when plaintiff failed to establish the propriety of the discovery on the two grounds it offered, the entire request, including the release of information which was allowed to be discovered in *Farm & Home* and *L.A.S. Enterprises*, was denied. Now, in its request for review of the trial judge's order, paragraph 7, plaintiff confines the discovery sought to such information, under such procedures, as approved by the court in *Farm & Home*. Secondly, in the course of the proceedings below, the Government objected to the proposed discovery on the grounds that production of the returns, or of information on the returns, would violate the third-party taxpayers' rights to confidentiality and would abridge section 1202 of the Tax Reform Act of 1976, now codified as part of 26 U.S.C. § 6103. In an attempt to mitigate this objection in part, and at the expense of identifying those among its alleged employees who considered themselves as self-employed, plaintiff modified its discovery request by suggesting deletion of the taxpayers' names from the returns or the return information produced. In *L.A.S. Enterprises*, this court overruled the Government's confidentiality objections, making plaintiff's modification unnecessary. Finally, plaintiff pegged its discovery request below on the thought that it could offer the tax returns in evidence to help prove, by virtue of what the taxpayers themselves declared on their returns, that its alleged employees considered themselves independent contractors. *Illinois Tri-Seal Products, Inc.* v. *United States*, 173 Ct. Cl. 499, 502, 353 F.2d 216, 218 (1965). Now that plaintiff has failed to surmount the hearsay obstacle in its intended path of proof, there can be little doubt that the obvious alternate route of establishing what the employees thought of their relationship with plaintiff—calling them as witnesses and permitting them so to testify—will be pursued. Plaintiff is entitled to know, under *Farm & Home* and *L.A.S. Enterprises*, how they characterized their relationship with it on their tax returns.

"In order to adjust for the foregoing, and to provide the same discovery opportunities for parties similarly situated,

negating the happenstance inequities arising from litigating postures and promises and from the parties' inability to anticipate this court's order in *L.A.S. Enterprises*, the trial judge's order must be vacated, and the discovery request returned to him and to the parties for further consideration in light of the above observations. Specifically, plaintiff is to be accorded the opportunity to amend its discovery request to seek the release of the information allowed to be discovered in *Farm & Home*, stating its purpose to be the identification of those of its alleged employees who in any way characterized their employment relationship with plaintiff on their tax returns.

"IT IS THEREFORE ORDERED, upon consideration of plaintiff's request for review and defendant's response thereto, without oral argument, that the request is granted and the trial judge's order issued on January 25, 1977, is vacated, and the case is remanded to the Trial Division for further proceedings consistent herewith."

No. 195–75. APRIL 26, 1977

Barry Walton

Civilian pay; appointment and tenure; "employee"; overtime pay; quantum meruit; authority of Government agent; Court of Claims jurisdiction.—On April 26, 1977 the court entered the following order:

George Elias, attorney of record, for plaintiff.

Vincent M. Garvey, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

Before DAVIS, *Judge*, Presiding, SKELTON and BENNETT, Judges.

"Plaintiff alleges that from November 1972 until June 1974 he was employed by the United States in and about Miami, Florida, under a Law Enforcement Assistance Administration program, pursuant to an undertaking with the Dade County School Board, 'his parent organization,' to work with the Drug Enforcement Administration Task Force program. In that capacity, as a special deputy United

States Marshal, he made arrests for the Government. He asserts that he worked approximately 100 hours a month overtime (to a total of almost 1,440 hours) but was compensated for only 39 hours per month on a straight-time basis. In count I of his petition he asks for overtime under the overtime provisions of Chapter 55 of Title 5 of the United States Code. In count II he seeks overtime on a quantum meruit basis, stating that others 'working in the same capacity out of other departments received time and a half for all overtime worked' and that the Government received and accepted the benefit of his services but failed to pay him therefor. The defendant has moved for summary judgment on both counts. We have considered the case, without oral argument, on the parties' written presentations.

"The undisputed affidavits make it clear that plaintiff was never appointed to a civil service position with the U.S. Marshal's Service and was never carried as an employee of that agency or its component parts. Nor was he appointed or purported to be appointed to any other position in the federal service. His only connection was that from November 1973 to May 1974 he was specially deputized by the United States Marshal for the Southern District of Florida. That post was not a classified position in the U.S. Marshal's Service, and the regulations authorize selected state and local law enforcement officers to be specially deputized to perform functions of a deputy U.S. Marshal.

"In these circumstances it is plain that count I fails to state a proper claim because plaintiff was not an 'employee' covered by the overtime provisions of Title 5 of the U.S. Code (*see* 5 U.S.C. §§ 2105, 5541(2)). He was not appointed in the civil service, or to a civil service position, by any officer empowered to make such appointment. *See, e.g., Goutos v. United States*, 212 Ct. Cl. 95, 552 F.2d 922 (1976). He was therefore beyond the coverage of the overtime legislation Congress has provided in Title 5 which is confined, insofar as the executive branch is concerned, to those designated classes of federal employees.

"As for count II, the claim in quantum meruit must fail because defendant's affidavits (and other materials) demonstrate that no one with whom plaintiff dealt had authority

to contract with him for overtime compensation or to appoint him to a position in the executive branch calling for overtime pay. Without such a contract or such an appointment he cannot recover from the United States. *See Bers v. United States*, 207 Ct. Cl. 941, order of May 30, 1975; *Haight v. United States*, 209 Ct. Cl. 698, *cert. denied* 429 U.S. 841 (1976); *Hughes v. United States*, 207 Ct. Cl. 1022, order of Aug. 1, 1975; *Spooner v. United States*, 211 Ct. Cl. 312, order of Sept. 10, 1976. The decision in *Norcross v. United States*, 142 Ct. Cl. 763, *rehearing denied*, 142 Ct. Cl. 767 (1958), differs in that the court there assumed that the legislative branch had authority to hire or contract with that plaintiff for the short period involved in that case. Insofar as plaintiff's claim attempts to stand on the Due Process Clause of the Fifth Amendment as mandating recovery of overtime pay, this court has no jurisdiction because that constitutional provision does not in itself obligate the Federal Government to pay money damages. *Muehlen v. United States*, 209 Ct. Cl. 690 (1976); *Eastport S.S. Corp. v. United States*, 178 Ct. Cl. 599, 372 F.2d 1002 (1967).

"IT IS THEREFORE ORDERED AND CONCLUDED that defendant's motion for summary judgment is granted and the petition is dismissed."

No. 373–75. APRIL 26, 1977

Hale Bros. Associates, Inc.

Patents; infringement; limitation on damages; marking and notice; available defenses and remedies; summary judgment, when appropriate.—The present phase of this patent infringement litigation is on the motions of defendant and third-party defendants, Xerox Corporation and General Electric Company, for partial summary judgment. The parties assert, *inter alia*, that neither plaintiff nor its licensees affixed to articles sold by plaintiff or its licensees the notice prescribed by 35 U.S.C. § 287 and that plaintiff failed to notify defendant of the infringement prior to filing the petition herein. The said third-party defendants also assert that plaintiff is barred by the Anti-Assignment

Statute (31 U.S.C. § 203) from maintaining the action, alleging that plaintiff, having acquired title to the patents in issue as of March 8, 1974, was not the owner of the patents at the time the claim against defendant first arose. General Electric Co. also contends that the petition should be dismissed as to it because it went out of the business to which the patents pertain prior to any period for which plaintiff may recover for infringement. Plaintiff contends that defendant has not yet established that any article has been manufactured or sold under the patents in suit, whether by plaintiff or its licensees, and that accordingly the matter is not ripe for disposition on summary judgment. Plaintiff also alleges that the *defenses* provided in 35 U.S.C. § 287 are not available to a defendant in a 28 U.S.C. § 1498 action. On November 24, 1976 Trial Judge Francis C. Browne filed a recommended decision (reported in full at 192 USPQ 114) denying the parties' motions insofar as they are predicated on the applicability of 35 U.S.C. § 287 to this case, the motions of the third-party defendants to the extent that they are predicated on the application of 31 U.S.C. § 203 to the present case, and the motion of General Electric Co. to the extent that it is predicated on the disposition of the relevant business prior to plaintiff's acquisition of title to the patents. The trial judge also discusses, *obiter dictum*, the issue raised by plaintiff concerning the availability of the *defenses* provided in 35 U.S.C. § 287. The trial judge points out that Sec. 287 is not a statutory *defense* to an action for infringement but is a limitation on damages as the heading of the section clearly states. On April 26, 1977 the court, sitting as a panel composed of *Judges* DAVIS, SKELTON and BENNETT, by order adopted the trial judge's decision as the basis for its judgment in this case as to the motions for partial summary judgment of defendant and said third-party defendants, denied the motions, and granted plaintiff's amended motion to dismiss as to Xerox Corporation and dismissed with prejudice the petition with respect to Xerox Corporation.

No. 36–76. APRIL 26, 1977

W. Vinten Limited

Patents; infringement; release; defenses available to United States.—On April 26, 1977 the court entered the following order:

Harold L. Novick, attorney of record for plaintiff. *Larson, Taylor and Hinds* and *Andrew E. Taylor,* of counsel.

A. David Spevack, with whom was *Acting Assistant Attorney General Irving Jaffe,* for defendant.

F. Trowbridge vom Baur, attorney of record for third party defendant. *vom Baur, Coburn, Simmons & Turtle* and *Hopewell H. Darneille III,* of counsel.

Before DAVIS, *Judge,* Presiding, SKELTON, and BENNETT, *Judges.*

"Plaintiff brought this action against defendant, seeking to recover compensation for the alleged infringement of plaintiff's patents No. 2,848,914, No. 2,921,511, and No. 2,931,284. Plaintiff contends that these patents were infringed by the unauthorized use and manufacture of the devices covered by the patents by the Department of the Navy and the Department of the Air Force. Such infringement allegedly occurred pursuant to contracts No. F42600–73–C–2138 ("2138") and No. F42600–74–C–1496 ("1496") between the Department of the Air Force and Mitchell Camera Corporation ("Mitchell"). Both of these contracts included indemnity clauses whereby Mitchell agreed to indemnify the defendant against any liability it might incur as a result of patent infringement by products covered by the contract. Pursuant to these indemnity clauses, defendant impleaded Mitchell as a third party defendant in this action. Mitchell has filed a counterclaim against plaintiff in the amount of $250,000, alleging that plaintiff violated an exclusive license agreement between plaintiff and Mitchell. The case is before the court on Mitchell's motion for summary judgment and plaintiff's response thereto. The government has for all practical purposes adopted Mitchell's brief in urging dismissal of plaintiff's petition.

"After much negotiation concerning disagreements between them, plaintiff and Mitchell signed a letter agreement on November 25, 1974, which is the crucial matter in this case. After a thorough review of the agreement and its background and the briefs of the parties, we hold that the agreement constitutes a general release of all outstanding matters between Vinten and Mitchell, and that Mitchell and the government are thereby discharged from any obligations to plaintiff.

"The clear and unambiguous language of the letter agreement unmistakably sets forth and reflects the specific intent of Mitchell to settle '*all* outstanding matters between them.' (Emphasis supplied.) Clause 1 of the agreement specifically provides that '[a]ll *contracts, licenses agreements and* obligations entered into between * * * [them] before the date of this letter agreement *are agreed to have terminated.*' (Emphasis supplied.) Similarly, Clause 2 provides that '[s]ave as provided under Clauses 3 and 4 below *there are no outstanding debts, liabilities or claims between* * * * [them].' (Emphasis supplied.) This language could hardly be made any broader or more inclusive. Vinten claims that it understood, from a statement by Mitchell's counsel that Vinten could not sue Mitchell for the so-called government infringements but would have to sue the United States under 28 U.S.C. § 1498, that the settlement negotiations did not have anything to do with those government infringements. If this was Vinten's belief, it was its own subjective unilateral mistake, not induced by any misrepresentation by Mitchell (or its counsel) and not shown in any way to have been known to Mitchell.

"The language employed is that of full and final settlement and constitutes a general release of all claims between the parties which are not expressly reserved or excepted from the scope of the agreement. Where the parties have executed a general release, this court has consistently held that claims which were not specifically excepted cannot thereafter be asserted. *See, e.g., J. G. Watts Constr. Co.* v. *United States,* 161 Ct. Cl. 801 (1963), and cases cited therein.

"Furthermore, in releasing its claim against Mitchell for patent infringement, plaintiff also released its right to recover for such infringement from the government under 28 U.S.C. § 1498. Plaintiff's claim against the government is barred because under 28 U.S.C. § 1498 the government stands in Mitchell's place and is entitled to all defenses available to Mitchell, including those of release and satisfaction. (It should be pointed out that while 28 U.S.C. § 1498 does not specifically so provide, provisions relating to the right of the United States to any general or special defense available to defendants in patent infringement suits which were originally included in 35 U.S.C. § 68 (1940 ed.) were omitted as unnecessary in subsequent revisions of this section. In the absence of a statutory restriction, any defense available to a private party is equally available to the United States.) Where a patentee's underlying claim against the infringing contractor is either defective or extinguished, there is no remaining cause of action against the government. There is no independent relationship between plaintiff and the government.

"This principle has been recognized in those cases holding that where the patentee has authorized the use of the patents by the contractor, either by license or otherwise, there is no remaining cause of action against the government under section 1498, even where the contractor has failed to pay the royalties required by its agreement with the patentee. *See, e.g., Roberts Dairy Co.* v. *United States,* 208 Ct. Cl. 830, 852–53, 530 F.2d 1342, 1357 (1976).

"Similarly, in *Bowser, Inc.* v. *United States,* 191 Ct. Cl. 567, 423 F.2d 1369 (1970) (Per Curiam), this court granted the defendant government's motion for partial summary judgment where the plaintiff had advised the third party infringing contractor in writing that it would not seek compensation for certain allegedly infringing items previously supplied by the contractor to the government.

"For all the foregoing reasons, and without oral argument, IT IS ORDERED that the third party defendant's motion for summary judgment be granted and the plaintiff's petition is dismissed. The third party defendant's counterclaim is disallowed and dismissed."

No. 151-76. APRIL 26,1977

Ralph E. Koontz

Civilian pay; suit for back pay; suspension without pay; charges not sustained in criminal prosecution; reclassification; failure to exhaust administrative remedies.—On April 26, 1977 the court entered the following order:

John H. Gullett, attorney of record, for plaintiff. *Gullett & Hines,* of counsel.

R. W. Koskinen, with whom was *Assistant Attorney General Rex E. Lee,* for defendant.

Before DAVIS, *Judge,* Presiding, SKELTON and BENNETT, *Judges.*

"This case is before the court on defendant's motion under Rule 38(c) for judgment on the pleadings. Plaintiff is a civilian employee of the Department of Housing and Urban Development (HUD) and seeks back pay, differentials, and allowances he would have earned during the period August 13, 1974, through August 6, 1975, while suspended indefinitely from his employment on account of an indictment against him on criminal charges by a Federal grand jury. Upon receipt of the notice of proposed suspension, plaintiff protested it unsuccessfully.

"On December 19, 1974, plaintiff was notified of a proposed action to change his position from Assistant to the Director of HUD's office in Jacksonville, Florida, a GS–14 position, to that of Program Analyst, GS–12. Defendant again protested to no avail, and he was reclassified at the lower grade, effective January 19, 1975.

"Plaintiff was brought to trial in the action styled *United States* v. *Gurney, et al.,* Crim. No. 74–122 CR-J-K, in the United States District Court, Middle District of Florida, and after a trial lasting many months he was acquitted by the jury on August 6, 1975. Plaintiff's suspension was terminated as of said date, and he was returned to duty, but was denied any back pay and allowances for the period of his suspension. Plaintiff tells the court that he is entitled to approximately the sum of $31,223.86 for the period claimed, and that defendant's personnel actions have been

unlawful as to him. The prayer for relief in the petition does not specifically contest plaintiff's reclassification, and we are pointed to no procedural errors therein. Defendant asserts, as affirmative defenses, failure of the petition to state a claim upon which relief can be granted and that the claim is barred by plaintiff's failure to exhaust his administrative remedy. We note, also, plaintiff has not alleged that his suspension was arbitrary and capricious. Plaintiff does suggest, however, that he can show, upon completion of discovery, that defendant's treatment of him has not been even-handed.

"The legality of an indefinite suspension of employment because of a criminal indictment was fully explored in our opinion in *Jankowitz* v. *United States*, 209 Ct. Cl. 489, 533 F.2d 538 (1976), where we found that such a procedure taken in good faith and in accordance with applicable civil service procedures must be sustained. We know of no authority to the contrary and plaintiff has shown us none.

"Upon consideration of the petition and supporting papers, defendant's motion, plaintiff's opposition thereto, and defendant's reply brief, without oral argument,

"IT IS ORDERED, upon the authority of *Jankowitz, supra,* that defendant's motion for judgment on the pleadings is granted, and the petition is dismissed."

No. 157-76 APRIL 26, 1977

Esso Belgium, successor by merger
to Esso Marine (Belgium), owner
and operator of the vessel
"Esso Brussels"

Water pollution control; oil spill clean-up costs.—On April 26, 1977 the court entered the following order:

James J. Higgins, attorney of record for plaintiff. *Kirlin, Campbell & Keating,* of counsel.

Clayton C. Ramsey, with whom was *Assistant Attorney General Barbara A. Babcock,* for defendant.

M. E. DeOrchis, attorney of record for third party defendant. *Haight, Gardner, Poor & Havens,* of counsel.

Before SKELTON, *Judge*, Presiding, COWEN, *Senior Judge*, and KUNZIG, *Judge*.

"Plaintiff brought this action under the Federal Water Pollution Control Act, 33 U.S.C. §§ 1251, et seq. (Supp V, 1975), to recover the costs of removing oil from the navigable waters of the United States, alleging that on the morning of June 2, 1973, while its vessel the 'ESSO BRUSSELS' was anchored in New York harbor, it was struck by the steamship 'C.V. SEA WITCH' owned by the third party defendant, American Export Lines, Inc., and that as a result of the collision there was a discharge of a large quantity of oil from the 'ESSO BRUSSELS' into New York harbor. Plaintiff further alleges that in cooperation with the United States Coast Guard, it removed the oil at its own expense, and that the discharge of the oil was caused solely by the act or omission of the third party, and accordingly, the plaintiff is entitled, under 33 U.S.C. § 1321 (i)(1) to recover its reasonable costs of removal. On defendant's motion, and pursuant to Rule 41(a)(1), a notice was issued and served on the third party, directing it to appear and assert its interest in the subject matter of this suit. The third party has appeared and has moved that the notice issued to it be dismissed on the ground that any proceeding herein by the third party is subject to a restraining order issued by the United States District Court for the Southern District of New York, and that the issues involved here can best be resolved by the litigation pending in the District Court. Alternatively, the third party requests that this court issue an order holding this action in abeyance pending the determination and resolution of the related issues involved in the New York suit.

"The court finds that after the collision of June 2, 1973, the third party, American Export Lines, Inc., commenced a proceeding to exonerate itself from or to limit its liability for any claims arising out of the collision. The action in the United States District Court for the Southern District of New York is docketed as 73 Civ. 2507 (CHT), and the third party has advised this court that the United States has filed claims against the third party in that action in the amount of $5 million and that the plaintiff herein has also filed claims therein against the third party

amounting to $12 million. In the same District Court action, the American Export Lines, Inc. is filing a cross suit against the United States for negligence which allegedly caused the collision.

"If plaintiff recovers the costs of removing the oil in this court, the United States will be entitled to bring an action against the third party in a District Court under the provisions of 33 U.S.C. § 1321(g) to recover the amount the Court of Claims finds is due plaintiff by the United States. Moreover, if the case in the Court of Claims proceeds to judgment against the United States, the Court of Claims judgment may very well operate as collateral estoppel against the third party on the issue of the cause of the oil spill. *Tanker Hygrade No. 18, Inc.* v. *United States*, 208 Ct. Cl. 488, 526 F.2d 805 (1975), *cert. denied*, 426 U.S. 920 (1976).

"In view of the foregoing, and since it appears that some of the critical issues that would have to be resolved in this action are the same as, or at least closely related to, the issues pending in the case in the Southern District of New York, the court has concluded that it is in the best interests of all of the litigants and in keeping with the 'concourse of claims' doctrine to stay further proceedings herein.

"IT IS THEREFORE ORDERED that the proceedings in this case are suspended until thirty (30) days after the United States District Court for the Southern District of New York hands down its decision in 73 Civ. 2507 (CHT), provided that proceedings in this court shall not be suspended during any appeal or appeals that may be taken from the decision of the United States District Court for the Southern District of New York unless the parties so stipulate or unless ordered by this court on motion of one or more of the parties."

Plaintiff's motion for reconsideration was denied June 24, 1977.

No. 430–76. APRIL 26, 1977

Dickie Diamond, a/k/a/
Alexander Randolph

Revenue laws; reward for information re violations of Internal Revenue laws; administrative discretion.—On April 26, 1977 the court entered the following order:

Richard A. Walsh, attorney of record for plaintiff. *Silverman and Walsh,* of counsel.

W. C. Rapp, with whom was *Acting Assistant Attorney General Myron C. Baum,* for defendant. *Theodore D. Peyser* and *Robert S. Watkins,* of counsel.

Before DAVIS, *Judge,* Presiding, SKELTON, and BENNETT, *Judges.*

"This single motion case is before the court on defendant's motion to dismiss plaintiff's petition. In his petition, plaintiff states that he furnished information which led to the arrest and conviction of various unspecified persons for violation of the internal revenue laws, and to the confiscation of money and property having a value allegedly in excess of $2,000,000. (The petition does not specify to whom such information was given, nor the nature of the alleged convictions.) Plaintiff applied in January of 1975 to the District Director of Internal Revenue for a reward. His application was supplemented in February, July, and August of 1975. By letter dated December 18, 1975, the District Director of Internal Revenue, Brooklyn, New York, informed plaintiff that his claim did not provide a basis for the allowance of a reward. This suit followed.

"Plaintiff apparently assumes that he is entitled to a reward for having provided the information described above. While it is true that Section 7623 of the Internal Revenue Code of 1954 does provide for the payment of rewards in such instances, payment is discretionary with the Secretary or his authorized representative. The Code provides that:

> The Secretary or his delegate, under regulations prescribed by the Secretary or his delegate, is authorized to pay such sums, * * * *as he may deem necessary*

> for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws, * * *. [26 U.S.C. § 7623 (1970)] [Emphasis supplied.]

"Section 301.7623–1 of the Treasury Regulations on Procedure and Administration provides in turn that:

> (a) A district director may approve such reward *as he deems suitable* for information that leads to the detection and punishment of any person guilty of violating any internal revenue law * * *.
>
> * * * * *
>
> (c) * * * The amount of a reward shall represent *what the district director deems to be adequate compensation in the particular case* * * *. [Emphasis supplied.]

"It is obvious from the above-quoted language that whether a reward should be paid in a particular case, and if so, the amount, are matters over which the district director has been given complete discretion. There is no language in the statute or the regulations which states or even implies that a reward *must* be paid.

"This court twice denied informers' claim for rewards in 1975. In *Saracena* v. *United States*, 206 Ct. Cl. 90, 508 F.2d 1333 (1975), the court held that the regulation cited above vested discretion in the district director to determine both whether a reward should be paid, and, if paid, the amount. The court also denied recovery in *McGrath* v. *United States*, 207 Ct. Cl. 978 (1975). Plaintiff has utterly failed to show any abuse of such discretion or lack of rational basis for the administrative determination. Therefore, plaintiff fails to state a claim upon which relief can be granted.

"Based on the foregoing facts and authorities, and without oral argument, IT IS ORDERED that defendant's motion be granted and the plaintiff's petition is dismissed."

No. 477–76. APRIL 26, 1977

Eugene J. and Annette B. Misiaszek

Court of Claims jurisdiction; damages for alleged conspiracy; tax assessment.—On April 26, 1977 the court entered the following order:

Eugene J. and Annette B. Misiaszek, pro se

Myron C. Baum, Acting Assistant Attorney General, for defendant.

Before DAVIS, *Judge,* Presiding, SKELTON and BENNETT, *Judges.*

"The *pro se* plaintiffs seek damages as a result of an alleged conspiracy conducted by the defendants to collect illegal tax monies from plaintiffs. Apparently the main actor in the alleged conspiracy, according to the very scanty petition, was the Director of the Department of Taxation and Finance of the State of New York. The defendant has moved to dismiss the petition as sounding in tort. This position is clearly correct. Plaintiffs seek damages for an alleged conspiracy but a case of that character is tortious and clearly beyond this court's jurisdiction. *See, e.g., Algonac Mfg. Co. v. United States,* 192 Ct. Cl. 649, 663, 428 F.2d 1241, 1249 (1970); *Vincin v. United States,* 199 Ct. Cl. 762, 468 F.2d 930 (1972); *Myers v. United States,* 206 Ct. Cl. 863 (1975). The court does not consider that it would be in the interest of justice under 28 U.S.C. § 1506 to transfer this case to a District Court since the claim does not fall within the Tort Claims Act. *See* 28 U.S.C. § 2680(c).

"IT IS THEREFORE ORDERED AND CONCLUDED, without oral argument, that the defendant's motion to dismiss is granted and the petition is dismissed."

Plaintiffs' motion for rehearing *en banc* and relief from judgment was denied June 24, 1977.

JUDGMENT ORDERS

PHILIP F. MARZEC v. THE UNITED STATES

No. 16–76

On February 4, 1977, the court entered judgment for plaintiff in full settlement of all claims set forth in the petition, based on a stipulated settlement entered into between the parties, in the sum of $12,162.93, the judgment order further providing that the United States upgrade plaintiff's discharge to "honorable" and expunge from plaintiff's military records the special fitness report, record of proceedings and any other reference to the charges brought against plaintiff (with the exception of one copy to be retained in a confidential file).

JOHN McSHAIN, INC. v. THE UNITED STATES

No. 357–72

[205 Ct. Cl. 892]

Pursuant to a stipulation of the parties in full settlement of all claims set forth in the plaintiff's petition and not previously disposed of, and in full settlement of all counterclaims asserted by the defendant, the court on February 4, 1977 entered judgment for plaintiff in the net amount of $1,962,413.21.

KARL F. KELLERMAN v. THE UNITED STATES

No. 128–73

[205 Ct. Cl. 484, 504 F.2d 1128; 208 Ct. Cl. 1045]

On December 12, 1975 the court entered judgment for plaintiff in the amount of $18,577.95. On February 14,

1977, pursuant to defendant's motion requesting correction of the order, the amounts of the judgment and stated credits were stricken, and the court ordered that judgment be entered for plaintiff in the sum of $19,808.80, of which $1,120.45 should be credited to plaintiff's Civil Service Retirement Fund Account and $110.40 should be credited to plaintiff's Federal Employee's Group Life Insurance Account, and the balance, or $18,577.95, should be paid to plaintiff.

GEORGIA-PACIFIC CORPORATION v. THE UNITED STATES

No. 882-71

On April 15, 1977, based on stipulated settlement entered into between the parties, the court entered judgment for plaintiff in the sum of $18,000,000 in full settlement of all claims set forth in the petition except as to claims set forth in paragraphs 17–20, 24, and so much of the claim in paragraphs 21–23 as relates to the claim in paragraphs 17–20, as to all of which further proceedings in the court are contemplated and dismissing all claims, demands, payments on the claim, counterclaims or offsets which defendant has asserted or could have asserted against plaintiff arising out of the claims set forth in the petition.

REPORT OF DECISIONS

OF

THE SUPREME COURT

IN COURT OF CLAIMS CASES

Action was taken by the United States Supreme Court on the parties' petitions for writs of certiorari as follows:

Petitioners	Ct. Cl.	F.2d	Supreme Court
			DENIED
Harold S. Rifkin	209:566		429 U.S. 1098
No. 437–70			Feb. 22, 1977
Sidney J. Hess, Jr., et al.	210:483	537:457	430 U.S. 931
No. 471–73			March 21, 1977
Solitron Devices, Inc.	210:352	537:417	430 U.S. 930
No. 133–75			March 21, 1977
Wendell Gordon, et al.	211:310		430 U.S. 930
No. 397–75			March 21, 1977
James H. Tanaka	210:712		430 U.S. 955
No. 330–75			April 4, 1977
Whitecliff, Inc.	210:53	536:347	430 U.S. 969
No. 407–74			April 18, 1977
			AFFIRMED
Consumer Life Ins. Co.	207:638	524:1167	430 U.S. 725
No. 463–70			April 26, 1977
Penn Security Life Ins. Co	207:594	524:1155	430 U.S. 725
No. 109–68			April 26, 1977

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WHICH HAVE BEEN PHOTOGRAPHED
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